INFORMATION STATEMENT

TENNESSEE VALLEY AUTHORITY

A Wholly Owned Corporate Agency and Instrumentality of the United States of America

The Tennessee Valley Authority ("TVA" or the "Corporation") presents this Information Statement (this "Statement") for the information of potential purchasers of (1) its Power Bonds ("Power Bonds"), (2) its Discount Notes ("Discount Notes") and (3) any other evidences of indebtedness ("Other Indebtedness") it may issue pursuant to the Tennessee Valley Authority Act of 1933, as amended (the "Act"). TVA issues Power Bonds pursuant to the Act and the Basic Tennessee Valley Authority Power Bond Resolution adopted by the Board of Directors of TVA (the "Board") on October 6, 1960, as amended on September 28, 1976, October 17, 1989, and March 25, 1992 (the "Basic Resolution"). TVA issues Discount Notes and Other Indebtedness pursuant to the Act and their authorizing resolutions. Power Bonds, Discount Notes and Other Indebtedness are collectively referred to in this Statement as "Evidences of Indebtedness."

TVA may offer Power Bonds and Other Indebtedness from time to time. TVA may offer Discount Notes for sale on a continuous basis by direct placement or through selected investment dealers, dealer banks, underwriters or underwriting syndicates. For each offering of Power Bonds, except for Power Bonds offered under a program on a continuous basis, TVA will prepare an offering circular describing the specific terms and conditions of the Power Bonds offered. For Power Bonds offered under a program on a continuous basis, TVA will prepare a single offering circular that describes the general terms and conditions common to all securities issued under the program. TVA will also prepare a single offering circular describing the general terms and conditions common to all Discount Note offerings. For offerings of Other Indebtedness, TVA will either prepare an offering circular describing the specific terms and conditions of the particular offering or a more general offering circular, as TVA deems appropriate. For any offerings made through a program under which Other Indebtedness, Discount Notes or Power Bonds are offered on a continuous basis, the offering circular will describe how, if at all, the offering circular will be supplemented in order to reflect, among other things, the specific terms and conditions of the securities being offered. You should read this Statement, as it may be supplemented or amended, together with the appropriate offering circular, as it may be supplemented or amended, for each offering.

For each offering of an Evidence of Indebtedness, you should rely only on the information contained in (1) this Statement, (2) the relevant offering circular and (3) any supplements or amendments to these documents approved by TVA. TVA has not authorized anyone to provide you with any information that is different from that found in this Statement and each relevant offering circular. This Statement does not constitute an offer to sell or a solicitation of an offer to buy any Evidences of Indebtedness in any jurisdiction to any person to whom it is unlawful to make an offer or solicitation.

This Statement is accurate only as of its date. TVA may supplement, amend or replace this Statement from time to time, generally no more often than annually, to reflect its annual financial results or otherwise as TVA deems appropriate. However, TVA assumes no further duty to update this Statement. You should rely on the most recent supplements or amendments to or replacement of this Statement over different information in this Statement.

You may obtain additional copies of this Statement by writing to Tennessee Valley Authority, 400 West Summit Hill Drive, Knoxville, Tennessee 37902-1401, Attention: Senior Vice President and Treasurer or by calling (865) 632-3366.

Evidences of Indebtedness are not obligations of the United States of America, and the United States of America does not guarantee the payment of the principal of or interest on any Evidences of Indebtedness. TVA is not required to register Evidences of Indebtedness under the Securities Act of 1933 or to make periodic reports to the Securities and Exchange Commission under the Securities Exchange Act of 1934. TVA does not intend to register any of its Evidences of Indebtedness or file any reports with the Securities and Exchange Commission.

The date of this Information Statement is February 8, 2001.

FORWARD-LOOKING STATEMENTS

This Statement contains forward-looking statements relating to future events and future performance. Any statements regarding expectations, beliefs, plans, projections, estimates, objectives, intentions or assumptions or otherwise relating to future events or performance may be forward-looking. Some examples include statements regarding TVA's projections of future power and energy requirements, future costs related to environmental compliance and targets for TVA's future competitive position. Although TVA believes that the assumptions underlying the forward-looking statements in this Statement are reasonable, TVA does not guarantee the accuracy of these statements. Numerous factors could cause actual results to differ materially from those in forward-looking statements. Such factors include, among other things, new laws and regulations, especially those related to the restructuring of the electric power industry and various environmental matters; increased competition among electric utilities; legal and administrative proceedings affecting TVA; the financial environment; performance of TVA's generating facilities; fuel prices; the demand for electricity; weather conditions; changes in accounting standards; and unforeseeable events.

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Information Statement

TENNESSEE VALLEY AUTHORITY

TVA is one of the largest electric power systems in the United States, having produced over 151 billion kilowatt-hours ("kWh") of electricity in fiscal 2000. TVA is a wholly owned corporate agency and instrumentality of the United States of America established by the Act to develop the resources of the Tennessee Valley region.

Historically, the programs at TVA have consisted of power and nonpower programs. Revenues and expenses of the power program are segregated from other revenues and expenses. Substantially all of TVA's revenues and assets are attributable to its power program.

The Act requires the power program to be self-supporting from power system revenues and capital TVA raises through its power program borrowings. The Act authorizes TVA to issue Evidences of Indebtedness in an amount not exceeding $30 billion outstanding at any one time, the proceeds of which may be used only for the power program. See "The Basic Resolution; Power Bonds, Discount Notes and Other Indebtedness."

Prior to fiscal 2000, congressional appropriations provided most of the funding for TVA's nonpower programs. TVA has obtained additional funds from revenues and user fees from the nonpower programs. In 1997, Congress enacted appropriations legislation that anticipated no further appropriations for the nonpower programs in fiscal years following 1998. This legislation required TVA, in the absence of appropriations, beginning in fiscal 1999, to fund certain nonpower programs constituting essential stewardship activities from various sources, which may include power revenues. Because Congress has not provided appropriations for TVA's nonpower programs since fiscal 1999, TVA primarily is using power funds (along with user fees, other forms of nonpower revenues and nonpower fund balances unused in prior years) for its essential stewardship activities in compliance with the 1997 appropriations legislation. In fiscal 2000, TVA spent approximately $40 million more in power funds on essential stewardship activities than it did in fiscal 1999 (see note 10 of the accompanying Financial Statements — Nonpower programs), and TVA expects in fiscal 2001 to spend approximately the same amount on such activities as it did in fiscal 2000. For a further discussion of this matter see "Public Law No. 105-62."

Congress reserved the right in the Act to alter, amend or repeal the Act but provided that no amendment or repeal shall operate to impair the obligation of any contract made by TVA in the exercise of any power conferred by the Act. For a discussion of legislation relating to the Act, see "Public Law No. 105-62."

TVA is administered by a board of three persons appointed by the President and confirmed by the United States Senate (the "Senate"). Appointments are for nine-year staggered terms, with one term expiring each three-year interval. The Board has the sole authority to determine the rates TVA charges for power. The Act requires the rates to be sufficient to cover certain costs. See "The Basic Resolution; Power Bonds, Discount Notes and Other Indebtedness" — "Rate Covenant" and "Competition."

The Act requires TVA to annually file a financial statement and complete report as to its business with the President and Congress. The Act authorizes the Comptroller General of the United States to periodically audit the transactions of TVA.

Under certain circumstances, the Act permits TVA to borrow up to $150 million for a period of one year or less from the United States Treasury (the "Treasury"). The Act requires TVA to obtain the approval of the Secretary of the Treasury of the issue date and maximum interest rate for any issuance of an Evidence of Indebtedness with a term of one year or longer. The Office of Management and Budget treats TVA's borrowing authority as budget authority for purposes of the budget of the United States.

Income on Evidences of Indebtedness issued by TVA is subject to United States federal income taxation and various other federal tax consequences. There is no special exemption for Evidences of Indebtedness from federal estate and gift taxes. Under the Act, Evidences of Indebtedness are exempt both as to principal and interest from all taxation now or hereafter imposed by any state or local taxing authority except estate, inheritance and gift taxes. This exemption might not extend to franchise or other nonproperty taxes imposed on corporations or to gain or loss realized upon the sale or exchange of an Evidence of Indebtedness even though such gain might in some cases be treated as interest income for federal income tax purposes.

SELECTED FINANCIAL DATA

The following selected financial data of TVA's power program for the fiscal years 1996 through 2000 have been derived from TVA's audited financial statements. These data should be read in conjunction with the audited financial statements and notes thereto (the "Financial Statements") presented herein.

Condensed Statements of Income
(in millions)

	Fiscal Years Ended September 30,				
	2000	1999	1998	1997	1996
Operating revenues	$6,762	$6,595	$6,729	$5,934	$5,951
Operating expenses	5,019	4,926	4,549	4,080	3,914
Operating income	1,743	1,669	2,180	1,854	2,037
Other income (expense), net	17	10	12	157	(10)
Income before interest expense and cumulative effect of change in accounting principle	1,760	1,679	2,192	2,011	2,027
Net interest expense	1,736	1,777	1,959	2,003	1,966
Cumulative effect of change in accounting principle	—	217	—	—	—
Net income	$ 24	$ 119	$ 233	$ 8	$ 61

Condensed Balance Sheets
(in millions)

	September 30,				
	2000	1999	1998	1997	1996
Assets					
Current assets	$ 1,426	$ 1,318	$ 1,656	$ 1,399	$ 1,306
Property, plant and equipment	28,314	28,417	28,891	29,298	29,521
Investment funds	840	731	578	561	440
Deferred charges and other assets	2,601	2,920	2,490	2,426	2,762
TOTAL ASSETS	$33,181	$33,386	$33,615	$33,684	$34,029
Liabilities and Proprietary Capital					
Current liabilities	$ 4,793	$ 3,117	$ 4,440	$ 3,853	$ 5,101
Other liabilities	2,455	2,156	2,007	1,704	1,580
Long-term debt	21,753	23,903	23,020	24,152	23,320
Proprietary capital	4,180	4,210	4,148	3,975	4,028
TOTAL LIABILITIES AND PROPRIETARY CAPITAL	$33,181	$33,386	$33,615	$33,684	$34,029

COMPARATIVE FIVE-YEAR DATA
STATISTICAL AND FINANCIAL SUMMARIES

	Fiscal Years Ended September 30,				
	2000	1999	1998	1997	1996
Sales (millions of kWh)					
Municipalities and cooperatives	125,991	122,880	123,330	114,771	117,035
Industries directly served	22,204	22,885	18,514	17,359	16,599
Federal agencies and other(a)	11,376	10,190	21,293	27,198	19,964
Total sales	159,571	155,955	163,137	159,328	153,598
Operating revenues (millions of dollars)					
Electric					
Municipalities and cooperatives	$5,676	$5,510	$5,554	$4,811	$4,980
Industries directly served	626	642	523	464	452
Federal agencies and other(a)	361	357	556	561	430
Other	99	86	96	98	89
Total revenues	$6,762	$6,595	$6,729	$5,934	$5,951
Electric revenue per kWh (cents)	4.18	4.17	4.07	3.66	3.82
Winter net dependable generating capacity (megawatts)					
Hydro(b)	5,544	5,492	5,491	5,384	5,298
Fossil	15,042	15,049	15,003	15,014	15,012
Nuclear units in service	5,729	5,729	5,620	5,625	5,545
Combustion turbine	3,154	2,232	2,384	2,394	2,268
Total capacity	29,469	28,502	28,498	28,417	28,123
System peak load (megawatts) — summer	29,344	28,295	27,253	26,661	25,376
System peak load (megawatts) — winter	25,940	26,388	23,204	26,670	25,995
Percent gross generation by fuel source					
Fossil	63%	63%	62%	61%	65%
Hydro	6%	7%	10%	11%	11%
Nuclear	31%	30%	28%	28%	24%
Fuel cost per kWh (cents)					
Fossil	1.27	1.28	1.25	1.23	1.23
Nuclear	.49	.51	.71	.58	.56
Aggregate fuel cost per kWh net thermal generation	1.05	1.05	1.10	1.04	1.06
Fuel data					
Net thermal generation (millions of kWh)	143,224	137,169	139,727	135,735	131,898
Billion Btu	1,470,452	1,403,110	1,426,151	1,381,837	1,338,157
Fuel expense (millions of dollars)	1,504	1,434	1,538	1,406	1,395
Cost per million Btu (cents)	102.29	102.21	107.81	101.73	104.22
Net heat rate, fossil only (average Btu per kWh)	10,267	10,229	10,207	10,180	10,145

(a) Sales and revenues have been adjusted to include sales to other utilities.
(b) Includes 405 megawatts of dependable capacity from the U.S. Army Corps of Engineers' projects on the Cumberland River System.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Results of Operations

FISCAL 2000 COMPARED TO FISCAL 1999

Operating Revenues

Operating revenues were $6,762 million in fiscal 2000, compared with $6,595 million in fiscal 1999. The $167 million increase was primarily due to an increase in energy sales to municipalities and cooperatives as a result of the hot summer during fiscal 2000. Accordingly, total kWh sales increased 3.6 billion kWh, from 156.0 billion in fiscal 1999 to 159.6 billion in fiscal 2000.

Operating Expenses

Operating expenses increased $93 million, or 2 percent, from $4,926 million in fiscal 1999 to $5,019 million in fiscal 2000. This increase was primarily due to higher fuel and purchased power expense of $183 million in fiscal 2000 as a result of hotter summer weather and increased power demand, and establishment of a $75 million inventory valuation reserve, partially offset by a $140 million reduction in the amount of accelerated amortization recorded in fiscal 2000 (see note 1 of the accompanying Financial Statements — Accelerated amortization).

Interest Expense

Net interest expense declined $41 million from $1,777 million in fiscal 1999 to $1,736 million in fiscal 2000. Total outstanding indebtedness as of September 30, 2000, was $26.0 billion, with an average interest rate of 6.83 percent; as of September 30, 1999, this amount outstanding was $26.4 billion, with an average interest rate of 6.83 percent.

FISCAL 1999 COMPARED WITH FISCAL 1998

Operating Revenues

Operating revenues were $6,595 million in fiscal 1999, compared with $6,729 million in fiscal 1998. The $134 million decrease was primarily due to a reduction in wholesale sales to other utilities related to mild weather and a weaker spot market for power during fiscal 1999.

Operating Expenses

Total operating expenses increased $377 million, from $4,549 million in fiscal 1998 to $4,926 million in fiscal 1999. This increase was primarily due to a $261 million charge for the acceleration of the amortization of regulatory assets (see note 1 of the accompanying Financial Statements — Accelerated amortization) coupled with a $111 million increase in the amortization of regulatory assets attributable to the reclassification of certain nuclear fuel costs (see note 1 of the accompanying Financial Statements — Other deferred charges).

Interest Expense

Net interest expense declined $182 million from $1,959 million in fiscal 1998 to $1,777 million in fiscal 1999. This reduction largely reflects savings associated with the refinancing of $3.2 billion of debt issues formerly held by the Federal Financing Bank. Total outstanding indebtedness as of September 30, 1999, was $26.4 billion, with an average interest rate of 6.83 percent; as of September 30, 1998, this amount outstanding was $26.7 billion, with an average interest rate of 7.45 percent.

Liquidity and Capital Resources

Capital Structure

During the first 25 years of TVA's existence, the U.S. Government made appropriation investments in TVA power facilities. In 1959 TVA received congressional approval to issue bonds to finance its growing power program. For the past four decades, TVA's power program has been required to be self-supporting. As a result, TVA funds its capital requirements through internal cash generation or through borrowings (subject to a congressionally mandated $30 billion limit).

A return on the U.S. Government's initial appropriation investment in TVA power facilities, plus a repayment of the initial investment, is specified by law. The payment for fiscal 2000 was $54 million, and total cumulative repayments and return on investment by TVA to the Treasury exceed $3 billion.

Cash Flows

Net cash provided by power program operations for fiscal 2000, 1999 and 1998 was $1,584 million, $1,431 million and $1,394 million, respectively. This positive trend reflects improvements made in TVA's operations during the three-year period.

Net cash used in investing activities for fiscal 2000, 1999 and 1998 was $1,035 million, $956 million and $742 million, respectively. The $79 million increase from fiscal 1999 to fiscal 2000 was primarily due to an increase in construction expenditures of $38 million reflecting the construction of natural gas combustion turbines for peaking power and an increase in nuclear fuel enrichment and fabrication costs of $49 million.

Net cash used in financing activities for fiscal 2000, 1999 and 1998 was $304 million, $763 million and $560 million, respectively. For fiscal 2000 the cash used in financing activities reflects the aggregate net reduction of total outstanding debt of $391 million coupled with borrowing costs and other financing costs of $202 million, offset by the proceeds from combustion turbine financing of $300 million.

Capital Resources

During fiscal 2000, 1999 and 1998, TVA accessed the capital markets through cost-effective long-term financing structures and continued to expand its investor base by tapping the global and domestic institutional and retail debt markets. During fiscal 2000 TVA entered the bond market with seven issues. TVA tapped the retail markets in February 2000 by issuing five callable bonds totaling $250 million with maturities ranging from 5 to 30 years. In May TVA issued 12-year bonds with a two-year put feature and a par value of $750 million, and because of the favorable response, issued an additional $250 million in July. The final bond offering of $1 billion in June targeted global investors and reestablished TVA's benchmark in the 30-year sector. In September TVA received approximately $300 million in proceeds by entering into a lease-leaseback transaction. The proceeds from these financing transactions were used to refinance existing debt.

Market Risk

Risk Policies

TVA is exposed to market risks, including changes in interest rates, foreign currency exchange rates and volatility of certain commodity and equity market prices. To manage the volatility attributable to these exposures, TVA has entered into various nontrading derivative transactions, principally an interest rate swap agreement, foreign currency swap contracts, forwards, futures and option contracts. TVA has established its Risk Management Committee, which maintains responsibility for reviewing and approving controls and procedures for TVA-wide risk management activities including the oversight of models and assumptions used to measure risk, the review of counterparty exposure limits and the establishment of formal procedures for use of financial hedging instruments.

TVA is exposed to losses in the event of counterparties' nonperformance and accordingly has established controls to determine the creditworthiness of counterparties in order to mitigate exposure to counterparty credit risk. With respect to hedging activities, TVA risk management policies allow the use of derivative financial instruments to manage financial exposures but prohibit the use of these instruments for speculative or trading purposes. Prior to October 1, 2000, TVA's effective implementation date for Statement of Financial Accounting Standards ("SFAS") No. 133, *Accounting for Derivative Instruments and Hedging Activities*, TVA accounted for such hedging activities using the deferral method, with gains and losses recognized in the accompanying financial statements when the related hedged transaction occurs. See further discussion related to TVA's fiscal 2001 adoption of SFAS No. 133 at *New Accounting Pronouncements.*

Interest Rate and Foreign Currency Risk

TVA manages its daily cash needs through issuance of Discount Notes and other short-term borrowings. These borrowings with maturities of less than one year expose TVA to fluctuations in short-term interest rates. TVA is not exposed to changes in interest rates on most of its long-term debt until such debt matures and may be refinanced at the then-applicable rates. An interest rate swap is used to hedge TVA's exposure related to its inflation-indexed accreting principal bonds, and currency swap contracts are used as hedges for foreign currency denominated debt issues (see note 5 of the accompanying Financial Statements — Foreign currency transactions and interest rate swap). Based on TVA's overall interest rate exposure at September 30, 2000, including derivative and other interest rate sensitive instruments, a near-term one percentage point change in interest rates would not have a material impact on TVA's financial position or results of operations for fiscal 2000.

Commodity Price Risk

TVA is exposed to the impact of market fluctuations in the price and transportation costs of certain commodities and fuels including, but not limited to, coal, natural gas and electricity. TVA employs established policies and procedures to manage risks associated with these market fluctuations by using various commodity-based derivative instruments, including futures, forwards and option contracts. To monitor the risk of commodity trading activities, TVA employs a daily Value at Risk ("VaR") methodology, which utilizes a statistical-based approach to determine adjusted historical changes in the value of a market risk sensitive commodity-based financial instrument to estimate the amount of change in the current value of the instrument that could occur at a specified confidence level over a specified interval. Based on TVA's VaR analysis of its overall commodity price risk exposure at September 30, 2000, management does not anticipate a materially adverse effect on TVA's financial position or results of operations as a result of market fluctuations.

Equity Price Risk

TVA maintains trust funds, consistent with the United States Nuclear Regulatory Commission requirements, to fund certain costs of decommissioning its nuclear generating units. These funds are managed by various money managers and are primarily invested in marketable equity securities, which are exposed to price fluctuations in equity markets. TVA actively monitors the trust funds' portfolios by benchmarking the performance of their investments against certain price indices. The accounting for nuclear decommissioning recognizes that, based on expected performance of the portfolio, sufficient funds have been set aside to fully fund expected decommissioning obligations, and, therefore, fluctuations in trust fund marketable security returns do not affect the earnings of TVA (see notes 1 and 9 of the accompanying Financial Statements — Decommissioning costs).

Accounting Standards

TVA accounts for the financial effects of regulation in accordance with SFAS No. 71, *Accounting for the Effects of Certain Types of Regulation.* As a result, TVA records certain regulatory assets and liabilities that would not be recorded on the balance sheet under generally accepted accounting principles for nonregulated entities.

TVA has approximately $979 million of regulatory assets (see note 1 of the accompanying Financial Statements — Other deferred charges and Debt issue and reacquisition costs) along with approximately $6.3 billion of deferred nuclear plants as of September 30, 2000. In the event that restructuring of the utility industry changes the application of SFAS No. 71, TVA would be required to evaluate such regulatory assets and deferred nuclear plants under the provisions of SFAS No. 121, *Accounting for the Impairment of Long-Lived Assets and Long-Lived Assets to Be Disposed Of.* SFAS No. 121 establishes criteria for evaluating and measuring asset impairments and states that regulatory assets no longer probable of recovery through future revenues be charged to earnings. Such an event may have a material adverse effect on future results of operations from the write-off of regulatory assets. However, TVA intends to seek full recovery of any regulatory assets that may result from the transition to a competitive market.

New Accounting Pronouncements

In June 1998 the Financial Accounting Standards Board ("FASB") issued SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities,* which requires that every derivative instrument (including certain derivative instruments embedded in other contracts) be recorded on the balance sheet as either an asset or a liability measured at its fair value. The statement requires that changes in the derivative's fair value be recognized currently in earnings unless specific hedge accounting criteria are met. In June 2000, the FASB issued SFAS No. 138, *Accounting for Certain Derivative Instruments and Certain Hedging Activities — An Amendment of FASB Statement No. 133*, further clarifying certain SFAS No. 133 implementation issues.

During fiscal 2000 TVA formed a cross-functional team to identify and evaluate business contracts and accounting transactions to determine the applicability of SFAS No. 133, and to develop required contemporaneous documentation and valuation methodologies for identified contracts to assess the effect on TVA's financial condition and results of operations upon adoption.

Effective October 1, 2000, TVA adopted the provisions of SFAS Nos. 133 and 138. Qualifying derivative contracts consisted of various purchased option contracts and certain currency and interest rate swap agreements (see note 5 of the accompanying Financial Statements — Foreign currency transactions and interest rate swap). TVA determined the fair value of such contracts to be approximately $51 million at October 1, 2000, by utilizing a variety of independent market sources. In accordance with SFAS No. 133, these contracts qualify for cash-flow hedge treatment. Accordingly, the effective portion of gains and losses related to such contracts is reported in accumulated other comprehensive income, while the ineffective portion is recognized through the creation of a regulatory asset/liability. The amounts accumulated in other comprehensive income and regulatory asset/liability are recognized in earnings upon settlement of the related contracts. Such treatment reflects TVA's ability and intent to account for these derivative instruments on a settlement basis for rate-making purposes. As of October 1, 2000, TVA determined the effective portion of the gains related to the derivative contracts to be approximately $51 million, which was recorded as a cumulative-effect type transition adjustment of accumulated other comprehensive income and approximately $0.3 million related to the ineffective portion (loss), which was recorded as a regulatory liability.

In December 1999 the Securities and Exchange Commission ("SEC") issued Staff Accounting Bulletin ("SAB") No. 101, *Revenue Recognition in Financial Statements*, summarizing the SEC's views in applying generally accepted accounting principles to selected revenue recognition issues. Although TVA is not required to do so, it will comply with the statement and believes that its practices already comply with the provisions of the bulletin. Its adoption is expected to have no material impact on TVA's reported results of operations, financial position or cash flows.

The FASB is proceeding with its project regarding accounting practices related to obligations associated with the retirement of long-lived assets and issued an Exposure Draft on *Accounting for Obligations Associated with the Retirement of Long-Lived Assets* in the first quarter of fiscal 2000. The proposed Statement would be effective for financial statements issued for fiscal years beginning after June 15, 2001. A second Exposure Draft on *Accounting for the Impairment or Disposal of Long-Lived Assets and for Obligations Associated with Disposal Activities* is currently out for comment. This proposed Statement would be effective for financial statements issued for fiscal years beginning after December 15, 2001. At the present time, TVA is unable to predict whether the implementation of these standards will be material to its results of operations or financial position.

Nuclear Decommissioning Costs

The FASB has undertaken a project regarding the accounting for closure and removal of long-lived assets, including the decommissioning of nuclear generating units. The FASB has reached several tentative conclusions with respect to the project; however, it is uncertain when a final statement will be issued and what impact it may ultimately have on TVA's financial position or results of operations.

TVA's accounting policy recognizes all obligations related to closure and removal of its nuclear units as incurred (see note 1 of the accompanying Financial Statements — Decommissioning costs). The liability for closure is measured as the present value of the estimated cash flows required to satisfy the related obligation and discounted at a determined risk-free rate of interest. The corresponding charge to recognize any additional obligation is effected through the creation of a regulatory asset. In addition, earnings from decommissioning fund investments, amortization expense of the decommissioning regulatory asset and interest expense on the decommissioning liability are deferred in accordance with SFAS No. 71.

THE AREA SUPPLIED BY TVA

TVA supplies power in most of Tennessee, northern Alabama, northeastern Mississippi and southwestern Kentucky, and in small portions of Georgia, North Carolina and Virginia. TVA serves a population of about eight million people. Subject to certain minor exceptions, TVA may not without specific authorization by act of Congress enter into contracts which would have the effect of making it or the distributors of its power a source of power supply outside the area for which TVA or the distributors were the primary source of power supply on July 1, 1957.

TVA is primarily a wholesaler of power. Its customers are composed of three major groups: (1) distributors, consisting of municipal and cooperative systems; (2) industries that have large or unusual loads; and (3) federal agencies. Additionally, TVA has entered into exchange power arrangements with most of its surrounding electric systems.

RATES, CUSTOMERS AND MARKET

The Act gives the Board sole responsibility for establishing the rates that TVA charges for power and authorizes the Board to include in power contracts terms and conditions that it judges necessary or desirable for carrying out the purposes of the Act. The Act requires TVA to charge rates for power which, among other things, will produce gross revenues sufficient to provide funds for (1) operation, maintenance and administration of its power system; (2) payments to states and counties in lieu of taxes; (3) debt service on outstanding Evidences of Indebtedness; and (4) annual payments to the Treasury in repayment of and as a return on the Government's appropriation investment in TVA power facilities (the "Appropriation Investment"). See "Certain Provisions of the Tennessee Valley Authority Act," "The Basic Resolution; Power Bonds, Discount Notes and Other Indebtedness" — "Rate Covenant," and "Public Law No. 105-62." Rates set by the Board are not subject to review or approval by any state or federal regulatory body. See "Competition."

A summary of power program operating revenues by customer type for each of the last five fiscal years ended September 30 is shown in the Comparative Five-Year Data presented on page 3.

Municipal and Cooperative Distributors

Sales to municipal and cooperative distributors accounted for approximately 84 percent of TVA's power revenues in fiscal 2000. TVA has long-term wholesale power contracts with 158 municipal and cooperative distributors. All of these contracts require distributors to purchase substantially all of their electric power and energy requirements from TVA.

All distributors purchase power under one of three basic arrangements. Fifty-eight distributors purchase power under contracts that require 10 years' notice to terminate and further provide that on each anniversary beginning on the tenth anniversary, one additional year is automatically added to the term. Four distributors have contracts that require 15 years' notice to terminate the contract. On each anniversary of these contracts, beginning on the fifth anniversary, one additional year is automatically added to the term. TVA has also offered distributors the option of moving from 10- or 15-year termination notice periods to a 5-year termination notice period. These contract amendments are conditioned upon notice not being given during the first five years after the effective date of the revision. Ninety-six distributors have entered into contractual arrangements of this type. TVA has agreed that all of these term arrangements are deemed to provide for adequate recovery by TVA of any investment in generation, transformation or transmission facilities for service to the distributor.

A number of TVA distributors, including some with the largest loads, have expressed interest in further revising their wholesale power contracts to allow them more options respecting contract term and other matters, such as purchasing only a portion of their power requirements from TVA. TVA has indicated its willingness to work with distributors to accommodate their desire for more flexibility. In fact, in April 2000, TVA implemented the Wholesale Energy to Market Program. This test program provides an opportunity for distributors of TVA power to gain knowledge and experience about wholesale energy markets while limiting their exposure to risk. On a weekly basis, participating distributors may elect to purchase power (in an amount equal to up to 5 percent of the average weekly energy taken by the distributor from TVA during the TVA fiscal year beginning October 1, 1997) and arrange for its delivery to the TVA system. TVA credits each participating distributor's wholesale power bill for the amount of power the distributor arranges for delivery to the TVA power system at the prices TVA quotes weekly for these deliveries. Each participating distributor continues to be a full requirements customer of TVA and must pay any additional costs incurred by TVA in the event of any disruption of the delivery arrangements made by the distributor under this program. For a discussion of events that may affect TVA's relationships with the distributors of its power, see "Competition."

TVA's wholesale power contracts contain standard provisions specifying the wholesale rates, resale rates and terms and conditions under which power is to be distributed. Under these contracts, TVA, on a quarterly basis, may determine and make adjustments in the wholesale rate schedule with corresponding adjustments in resale rate schedules necessary to enable TVA to meet all requirements of the Act and the financial covenants and provisions of its bond resolutions. The contracts provide for agreement between the parties on general or major changes in both the wholesale and resale rate schedules. If, however, agreement is not reached, the contracts permit TVA to make changes in these schedules to carry out the objectives of the Act, to meet financial requirements and covenants and to comply with the provisions of its bond resolutions.

The power contracts between TVA and the distributors of TVA power specify the resale rates that distributors charge the ultimate power consumers. These rates are revised from time to time to reflect changes in costs, including changes in the wholesale cost of power. They are designed to promote the Act's objective of providing an adequate supply of power at the lowest feasible rates.

Other Sources of Power Revenues

Revenues from industries and federal agencies directly served and from exchange power arrangements with other power systems and other revenue accounted for approximately 16 percent of TVA's power revenues in fiscal 2000. Contracts with industries directly served by TVA are normally for 10-year terms. These contracts are subject to termination by TVA or the customer upon a minimum notice period that varies according to the customer's contract demand and the period of time service has been provided to the location where it is to be terminated. TVA establishes the rates it charges industries it directly serves. These rates normally are the same as those charged by the distributors of TVA power to large industries (those with demand greater than 25,000 kilowatts). TVA generally sells power to federal agencies under the same contract terms and rates as directly served industries. TVA has exchange power arrangements with 12 neighboring power systems. See note 1 of the accompanying Financial Statements.

COMPETITION

The electric utility industry has become increasingly competitive over the last decade. Competition is expected to continue to intensify, and restructuring legislation may dramatically change the way electric utilities do business in the future. Among the early initiatives that have begun to promote industry competition is the Energy Policy Act of 1992 (the "Energy Act"). The Energy Act, and related Federal Energy Regulatory Commission ("FERC") orders, already allow competitors of a utility to access that utility's transmission system to sell electricity to other electric power suppliers and wholesale customers. In TVA's case, some special provisions apply.

Under the TVA Act, subject to certain minor exceptions, TVA may not currently enter into contracts that would have the effect of making it or the distributors of its power a source of power supply outside a statutorily specified area. However, under a special provision of the Energy Act (the "anti-cherry-picking provision"), TVA is not required to provide its competitors access to its transmission system to transmit power for consumption within the area that TVA or the distributors of its power may serve. Thus, while TVA may not sell power outside its current service area, its competitors are not allowed to use its transmission system to sell power within TVA's service area.

In the future, it is likely that the current law that serves to limit competition between TVA and its competitors will change. In the past three years, numerous bills have been introduced in Congress designed to restructure the electric utility industry and mandate or promote competition in the industry. Within the context of restructuring legislation, some of the key issues for TVA are: (1) whether TVA rates will be regulated by FERC, (2) whether TVA and the distributors of TVA power will be able to sell power outside the TVA service area and whether TVA will be required to provide its competitors access to its transmission system to transmit power for consumption within the TVA service area, (3) whether Congress will attempt to shorten the terms of TVA's present wholesale power contracts with the distributors of its power and (4) whether TVA will have the right to recover its power system investments that would no longer be economical under full and open market competition (stranded costs).

Since the early days of the federal electric power industry restructuring effort, TVA has been working closely with the Tennessee Valley Public Power Association ("TVPPA"), the association which represents all distributors of TVA power, and the Tennessee Valley Industrial Committee ("TVIC"), an organization representing industries that TVA directly serves, to develop a consensus position on industry restructuring. After a series of negotiations, TVA, TVPPA and TVIC agreed upon the key elements of legislation regarding TVA. This legislation would allow for: (1) simultaneous repeal of the anti-cherry-picking provision and the fence on the effective date of the restructuring legislation, (2) renegotiation of power contract terms with a minimum termination notice period of three years, and a distributor option to take partial requirements from other suppliers with advance notice to TVA, (3) new limitations on TVA retail sales in TVA's current service area, (4) stranded cost recovery, (5) FERC regulation of TVA's transmission system, (6) TVA subjection to antitrust laws (with the exception of civil damages and attorney's fees), (7) reduction of most of TVA's existing regulatory role with respect to distributors and (8) limitation on new TVA generation to that needed to meet demand within the current TVA service territory. No provisions were included with respect to TVA wholesale rate regulation. In May 2000, Senators Frist, Thompson and Cochran introduced a bill in the Senate that incorporates this consensus position. TVA anticipates that a similar bill will be introduced during this congressional session.

Other restructuring bills that would affect TVA have been introduced in prior sessions of Congress as part of the federal effort to develop restructuring legislation. Although a great deal of attention has been given to this issue, federal legislation will continue to be debated well into the year 2001 and beyond. Whatever the outcome of the legislative process, TVA's management has developed and will continue to develop plans and strategies designed to position TVA for competitive success in a restructured industry.

POWER AND ENERGY REQUIREMENTS

TVA prepares annual forecasts of future power and energy requirements as part of its planning and budgeting process. TVA's forecast procedure involves producing a range of load forecasts for the explicit purpose of bounding the range of uncertainty associated with load growth. TVA produces the load forecasts probabilistically. TVA believes that there is a 90 percent probability that the actual load will be less than the high load forecast, a 50 percent probability that the actual load will be less than medium load forecast and a 10 percent probability that actual load will be less than the low load forecast. TVA's current load forecast through fiscal 2002 reflects an average annual load growth rate of 2.9 percent, 1.8 percent and 0.8 percent for the high, medium and low load forecasts, respectively. TVA's total system energy requirements through fiscal 2002 reflect an average annual growth rate of 2.9 percent, 1.9 percent and 0.6 percent for the high, medium and low load forecasts, respectively. Numerous factors, such as weather conditions and the health of the regional economy, could cause actual results to differ materially from TVA's forecasts.

POWER SYSTEM

TVA's power system is one of the largest in the United States in capacity and in energy production. Its size permitted the construction of large facilities which resulted in lower unit costs. Most of TVA's dams were completed years ago when construction costs were far below present-day levels. Because most of the dams are multipurpose, their cost is shared by navigation, flood control, recreation and local economic development, as well as by power. Thus, each purpose is served at a substantially lower cost than if the dams had been built for a single purpose.

TVA's power generating facilities at September 30, 2000, included 29 hydroelectric plants, 11 coal-fired plants, 3 nuclear plants, 1 pumped storage hydroelectric plant and 4 combustion turbine plants. Power is delivered to TVA customers over a transmission system of approximately 17,000 miles of lines, including 2,400 miles of extra-high-voltage (500,000 volt) transmission lines. The system interconnects with neighboring power systems at numerous points. TVA has various types of interchange arrangements with these systems. The extent and types of interchange transactions depend upon the characteristics of the systems' loads, the management policies of the systems and other factors. Interchange arrangements are an essential part of TVA's efforts to minimize investment in electrical facilities, increase the reliability of service, effect operating economies and minimize the cost of electric energy.

During the fiscal year ended September 30, 2000, 63 percent of the power generated by the TVA coordinated system was by fossil-fired plants and combustion turbines, 31 percent by nuclear and 6 percent by hydro. Coal consumption during this time was 41.9 million tons. Coal is purchased under contracts ranging from a single delivery to deliveries over several years. TVA coal inventory levels vary from plant to plant based upon a simulated inventory model. As of September 30, 2000, TVA had approximately 20 days' coal supply in inventory at full burn. See "Nuclear Power Program" — "Nuclear Fuel" for a discussion of TVA's nuclear fuel supplies. Management believes the sources and availability of fuel materials essential to its business should be adequate for the foreseeable future.

Generating Resources

The following table summarizes the winter net dependable capacity ("NDC") in megawatts ("MW") on this coordinated system as of September 30, 2000:

	Generating Units	Winter NDC MW(1)
TVA Hydro Plants	109	3,289
TAPOCO Hydro Plants		318(2)
U.S. Army Corps of Engineers Hydro Plants		405(3)
TVA Pumped Storage Facility	4	1,532
Total Hydro		5,544
Fossil	59	15,042
Nuclear	5	5,729
Combustion Turbine	56	3,154
Total NDC		29,469

(1) NDC as stated is the net power output which can be obtained for a period adequate to satisfy the daily load patterns under expected conditions of operation with equipment in an average state of maintenance. For planning purposes, TVA currently estimates summer dependable total hydro capacity of approximately 5,770 MW, coal-fired capacity of approximately 14,703 MW, nuclear power capacity of approximately 5,583 MW and combustion turbine capacity of approximately 2,556 MW, for a total summer NDC of approximately 28,612 MW.

(2) Four hydro plants owned by TAPOCO, Inc., a subsidiary of the Aluminum Company of America ("Alcoa"), are operated as part of the TVA power system. Under contractual arrangements with TAPOCO, electric power generated at these facilities is supplied to TVA. In return, TVA supplies electric power for Alcoa's aluminum plant operations located in Tennessee.

(3) The U.S. Army Corps of Engineers' plants on the Cumberland River system have a total installed capacity of 975 MW, of which 405 MW of NDC is available to TVA under a marketing agreement with the Southeastern Power Administration.

Under arrangements among TVA, the U.S. Army Corps of Engineers (the "CORPS") and the Southeastern Power Administration ("SEPA"), eight hydro plants of the CORPS on the Cumberland River system are operated in coordination with the TVA system. These arrangements further provide for capacity (405 MW) and energy from the Cumberland River system to be supplied to TVA by SEPA at the points of generation and the price paid for the power to be based on the operating and maintenance expenses and amortization of the power facilities. A portion of the output of the Cumberland River system is also made available to SEPA's customers outside the TVA region. The agreement with SEPA covering these arrangements for power from the Cumberland River system can be terminated upon three years' notice. This notice may be given beginning June 30, 2017.

TVA has contracted with Choctaw Generation, Inc., to purchase and take delivery of up to 440 MW of power over a 30-year term from a lignite power plant being constructed in Mississippi. Commercial operation of the plant is currently scheduled for May 2001. The owner of the facility bears the construction and operating risks. If the owner fails to deliver the required energy, the owner will be responsible for securing replacement power for TVA at the contractually agreed price.

TVA installed eight 85 MW natural-gas combustion turbines in time for the summer 2000 peak demands for power. Four units were installed at the Gallatin plant and four at the Johnsonville plant, both of which have existing combustion turbines. TVA is also planning to install up to eight additional 85 MW natural-gas combustion turbines in 2001.

TVA is also supplementing its existing generation portfolio with additional renewable resource assets (primarily wind, solar and landfill gas technologies). These assets are projected to account for about 7 MW of additional capacity at the present time.

ELECTRICITY FUTURES CONTRACTS

TVA may enter into electricity futures contracts for the sole purpose of limiting or otherwise hedging TVA's economic risks directly associated with electric power generation, purchases and sales. The Chicago Board of Trade has designated the TVA power transmission system as a hub for electricity futures contracts.

NUCLEAR POWER PROGRAM

Overview

TVA has five operating nuclear units, three deferred nuclear units and one inoperative nuclear unit. Selected features of each of these units are described in the chart below.

Nuclear Unit	Status	Installed Capacity (Megawatts)	Average Percent Equivalent Availability for FY 2000(1)	Date of Expiration of Operating License	Date of Expiration of Construction License
Sequoyah Unit One	Operating	1,221	89.7	2020	—
Sequoyah Unit Two	Operating	1,221	99.1	2021	—
Browns Ferry Unit Two	Operating	1,190	98.7	2014	—
Browns Ferry Unit Three	Operating	1,190	92.0	2016	—
Watts Bar Unit One	Operating	1,270	93.0	2035	—
Watts Bar Unit Two	Deferred	—	—	—	2010
Bellefonte Unit One	Deferred	—	—	—	2001
Bellefonte Unit Two	Deferred	—	—	—	2004
Browns Ferry Unit One	Inoperative	—	—	2013	—

(1) The "equivalent availability" is the ratio of energy a unit could have generated, if called on, to the energy the unit would have produced if it had run at full load over the entire period measured, expressed as a percentage.

Status of Certain Nuclear Units

Preliminary cost estimates showed that completing the units at Bellefonte and Watts Bar Unit Two may not be economically feasible. Consequently, in December 1994 the Board announced that TVA will not, by itself, complete Bellefonte Units One and Two and Watts Bar Unit Two as nuclear units. Additionally, the Board decided that Browns Ferry Unit One would continue in its inoperative status.

TVA has identified as a viable option the conversion of the Bellefonte facility to a combined-cycle plant utilizing natural gas or gasified coal. In 1997 an independent team of technical and financial experts completed a feasibility study to evaluate options for the conversion of Bellefonte Nuclear Plant to a fossil fuel-fired plant. The feasibility study indicates that one of the most economical fossil conversion strategies is to complete Bellefonte as a natural gas-fired combined-cycle plant. TVA also issued an Environmental Impact Statement ("EIS") assessing the environmental impacts of various fossil conversion options. The EIS identified the natural gas-fired combined-cycle plant alternative as the preferred option.

An agreement has been reached between TVA and DOE for TVA to use Watts Bar Unit One and its Sequoyah Nuclear Units, if necessary, to provide irradiation services for the production of tritium, an isotope of hydrogen that is used in all of the United States' nuclear weapons. TVA's efforts during the first three to four years of the proposed agreement would focus on obtaining operating license amendments to allow the provision of irradiation services and on performing any necessary modifications to the plants to enable TVA to provide irradiation services.

At September 30, 2000, TVA's total investment in Bellefonte Units One and Two, Watts Bar Unit Two and Browns Ferry Unit One was $6.4 billion. TVA's future decisions regarding these units will ultimately impact the method of cost recovery. The Board has determined that it will establish rate adjustments and operating policies to seek full recovery of the cost of these units and compliance with the requirements of the TVA Act.

Nuclear Fuel

TVA owns all nuclear fuel held for its operating and deferred nuclear units. The net book value of this fuel was $379 million as of September 30, 2000. TVA will fill future uranium requirements by a combination of term and spot purchase contracts while maintaining diversity of supply source. TVA currently has approximately 90 percent of its forward five-year (2001-2005) uranium requirements either in inventory or under contract. TVA generally fills conversion, enrichment and fabrication services needs on a requirements basis under term contracts.

TVA's investment in the fuel being used in the Sequoyah, Watts Bar and Browns Ferry units is being amortized and accounted for as a fuel expense. The Bellefonte initial cores have been defabricated, and uranium from these cores has been used in the Sequoyah and Browns Ferry units with the net book value assigned accordingly.

Nuclear Waste

Spent Nuclear Fuel

The Nuclear Waste Policy Act of 1982 (the "NWPA") gives the federal government the responsibility for the permanent disposal of spent nuclear fuel but gives each nuclear power system the responsibility for the cost of permanent disposal. The NWPA requires each nuclear power system to enter into a disposal contract with DOE for spent nuclear fuel. This contract requires each nuclear power system to pay a fee that is currently one mill per kWh for the net electricity generated by each of its reactors and sold. Although it is uncertain when DOE will be able to begin accepting spent nuclear fuel, TVA believes its spent-fuel efforts will ensure that sufficient at-reactor storage is available to meet all of TVA's spent-fuel storage requirements until DOE is prepared to accept TVA's spent fuel.

TVA presently has the capability to store its spent fuel at Sequoyah until September 2004, at Browns Ferry Units One and Two until January 2013 assuming only Unit Two operation, and at Browns Ferry Unit Three until January 2006. Based on one-unit operation, TVA has the capability to store its spent fuel at Watts Bar until September 2018.

TVA plans to extend storage capability through life-of-plant if necessary by using dry storage casks in independent spent-fuel storage installations located at Browns Ferry and Sequoyah Nuclear Plants. Such spent-fuel storage arrangements require NRC approval. However, such arrangements have been approved by the NRC at other facilities.

Low-Level Radioactive Waste

Disposal costs for low-level radioactive waste that result from normal operation of nuclear units have increased significantly in recent years. Pursuant to the Low-Level Radioactive Waste Policy Act, each state is responsible for disposal of low-level waste generated in that state. States may form regional compacts to jointly fulfill their disposal responsibilities. The States of Tennessee and Alabama (where TVA's nuclear plants are located) have joined with other southeastern states to form the Southeast Compact Commission for Low-Level Radioactive Waste Management. This commission regulates the siting of new disposal facilities and the disposal of low-level waste within the southeastern states.

Until July 1995, the low-level waste generators located in the southeastern states were required to dispose of their radwaste at the Barnwell, South Carolina, disposal facility. Barnwell is no longer a member of the Southeastern states compact. Recently, South Carolina announced volume caps that cannot be exceeded due to the acceptance of waste from states that are not members of the

Atlantic Interstate Low-Level Radioactive Waste Compact. After June 2009 no waste will be accepted from such states, which include Tennessee and Alabama.

As a result of its review of its storage and disposal options for low-level radwaste management, TVA in 1999 began storage of the type of low-level radwaste that had previously been sent to Barnwell at the storage facilities on two of TVA's plant sites. These facilities are sized to handle the anticipated storage needs for the foreseeable life of TVA's operating plants. TVA continues to send dry radioactive waste to the Envirocare of Utah disposal facility in Clive, Utah, based on economics.

Nuclear Insurance

In 1988 Congress extended the indemnification and limitation of liability plan afforded the United States nuclear industry by the Price-Anderson Act for an additional 15 years. Certain provisions of the Price-Anderson Act are due to expire on August 1, 2002. Should the extension of these provisions be delayed beyond the expiration date, or should these provisions not be extended for any reason, the existing indemnification and limitation of liability plan would continue to apply to TVA's nuclear plants. Under the Price-Anderson Act, the limit of liability from an accident at an NRC-licensed reactor is approximately $9.3 billion ($88 million for each of the NRC-licensed reactors in the United States), composed of primary and secondary layers of financial protection. This amount is periodically adjusted for inflation. For further information about this nuclear liability insurance and its deferred premium, see note 9 of the accompanying Financial Statements. In accordance with industry practice, TVA maintains certain liability insurance coverage for workers at its nuclear sites.

NRC regulations require nuclear power plant licensees to obtain, and TVA has acquired, onsite property damage insurance coverage of $1.06 billion per nuclear site. Some of the nuclear property insurance may require the payment of retrospective premiums of up to approximately $16.4 million in the event that losses by another insured party or TVA exceed available funds. In accordance with NRC regulations, the proceeds of nuclear property insurance are first used to ensure that the reactor is in safe and stable condition and that it can be maintained in a condition that prevents significant risk to the public. Next, the proceeds are used for decontamination or, if necessary, decommissioning the reactor. Any excess proceeds insure against casualties to property.

Decommissioning

Consistent with NRC requirements, TVA has established and funded a decommissioning trust to assure the availability of adequate funds for decommissioning TVA's nuclear plants. Investments held by the trust are expected to grow to be sufficient to fully fund all estimated decommissioning costs.

TVA recognizes, as incurred, all obligations related to closure and removal of its nuclear units. TVA measures the liability for closure at the present value of the estimated cash flows required to satisfy the related obligation, discounted at a determined risk-free rate of interest. The corresponding charge to recognize the additional obligation was effected through the creation of a regulatory asset. Earnings from decommissioning fund investments, amortization expense of the decommissioning regulatory asset and interest expense on the decommissioning liability are deferred in accordance with Statement of Financial Accounting Standards No. 71, "Accounting for the Effects of Certain Types of Regulation." The book value of TVA's decommissioning fund investments was $770 million at December 31, 2000. See notes 1 and 9 of the accompanying Financial Statements.

ENVIRONMENTAL MATTERS

TVA's activities are subject to various federal, state and local environmental statutes and regulations. Major areas of regulation affecting TVA's activities include air pollution control, water pollution control and management and disposal of solid and hazardous wastes. Because TVA is a federal agency, it is subject only to those state and local environmental requirements for which Congress has clearly waived federal agency immunity. Respecting the major environmental areas (air, water and waste), limited waivers have been enacted by Congress. TVA's activities may also be subject to other narrower environmental requirements or to environmental requirements that affect only federal activities.

TVA has incurred and continues to incur substantial capital expenditures and operating expenses to comply with environmental requirements. See note 9 of the accompanying Financial Statements. Because these requirements change frequently, the total amount of these costs is not now determinable. It is anticipated that environmental requirements will become more stringent and that compliance costs will increase, perhaps by substantial amounts.

Air Quality

Under the Clean Air Act, the United States Environmental Protection Agency ("EPA") has promulgated national ambient air quality standards for certain air pollutants, including sulfur dioxide, particulate matter and ozone. Coal-fired generating units such as TVA's are major sources of these pollutants or their precursors. TVA also operates other facilities that are smaller sources of these pollutants. The States of Alabama and Tennessee and the Commonwealth of Kentucky have promulgated implementation plans that regulate sources of air pollution within their boundaries, including TVA sources, in order to achieve and maintain the national ambient standards. TVA has installed air pollution control equipment and employs strategies to comply with applicable state-established emission limitations.

The 1990 Amendments to the Clean Air Act established a number of new requirements relating to acid rain control, including additional requirements relating to sulfur dioxide and nitrogen oxide emissions, that are to be met in two phases. Through 2000, TVA had invested approximately $1 billion in capital for Phase I and Phase II compliance. TVA estimates it will spend roughly an additional $100 million in capital through 2003 to finalize the Phase II compliance measures. This will complete TVA's program for reducing sulfur dioxides and nitrogen oxides to comply with the acid rain control requirements of the 1990 Amendments to the Clean Air Act.

During 1998 TVA adopted a new clean air strategy to install ten selective catalytic reduction systems ("SCRs") that is designed to reduce nitrogen oxide emissions from its coal-fired plants. In 2000, TVA committed to an additional eight SCRs to further reduce its nitrogen oxide emissions. The cost of implementing this strategy in total is expected to be in excess of $850 million in addition to amounts TVA has already spent to comply with the 1990 Clean Air Act Amendments. TVA's new strategy should bring TVA into compliance with EPA's ozone-transport regulations. However, recent court decisions have overturned or delayed other ozone related regulations. While these court decisions may have some effect on TVA's plans, TVA is committed to improving the air quality of the region.

EPA has finalized new, more stringent particulate matter standards and a rule to reduce regional haze. These actions may require TVA to make additional reductions of sulfur dioxide emissions beyond those currently planned. TVA anticipates that compliance with the new regulations will be required after 2012.

TVA cannot with certainty determine the costs for additional reductions of nitrogen oxide, sulfur dioxide and particulate matter emissions beyond those required by the acid rain provisions of the 1990 Amendments to the Clean Air Act. In addition, the D.C. Circuit Court overturned the ozone and fine particulate matter standards, and the Supreme Court has agreed to review this decision. The regional haze rule has also been challenged in the D.C. Circuit Court. These actions create additional uncertainty regarding future air regulatory requirements facing utilities. However, the costs for these additional reductions could exceed $2.5 billion.

EPA is investigating whether coal-fired utilities in the eastern U.S., including TVA, may have modified their coal-fired boilers without complying with new source review requirements. TVA contends EPA's investigation is based on a new interpretation of an old rule and that TVA has routinely maintained its power plants to ensure efficient, reliable power generation while complying with all requirements. The outcome of this investigation is ongoing and uncertain. However, EPA has issued TVA an administrative order directing TVA to put "new-source" controls on 14 of its units and to evaluate whether more controls should be installed on other units. TVA has challenged the validity of this order and the Eleventh Circuit Court of Appeals has stayed the order pending its review. The U.S. Department of Justice ("DOJ") is seeking to have TVA's petition for review dismissed on the basis of DOJ's view that TVA lacks legal authority to file the petition and that EPA's order should not be viewed as "final." TVA disagrees with DOJ's view. It is not possible to predict with certainty what impact implementation of EPA's order would have on TVA if TVA's challenge is unsuccessful. If EPA substantially prevails, TVA could be required to incur capital costs in excess of $3 billion by 2010 to 2015 in order to implement EPA's order. Any additional controls that TVA could be required to install on units as a result of this matter would, however, also be sufficient to comply with reduction requirements that are anticipated under other air quality programs discussed above. Thus, because of the other environmental program requirements, TVA would, in any event, likely have to incur a substantial portion of the costs that might result from the EPA enforcement action, albeit the schedule for the installation of the controls could be accelerated by the EPA enforcement action. TVA fully supports the need to further reduce emissions from coal-fired plants and seeks a resolution that will not put TVA customers and the region at a disadvantage.

On September 15, 2000, an internal appeals panel of EPA issued a decision on reconsideration of the administrative order EPA issued to TVA in November 1999. The reconsideration decision upheld most of EPA's legal claims, but dismissed part of them. TVA has asked the federal appeals court to review this internal EPA decision, and the court has now consolidated all of these proceedings in one case. TVA has also received notices from two environmental groups that they intend to sue TVA in federal district courts raising the same allegations made by EPA.

The United States signed the Kyoto Protocol to the United Nations Framework Convention on Climate Change in November 1998. If ratified by the Senate, the protocol would require the United States to reduce its annual greenhouse gas emissions (including carbon dioxide) around 2008 to 2012 to a level 7 percent below 1990 emission levels. Such a national requirement would likely require electric utilities to achieve similar reductions. The costs to utilities to achieve these reductions could be substantial. It appears unlikely, however, that the Kyoto Protocol will be ratified with this reduction level and schedule.

Water Quality

Under the Clean Water Act ("CWA"), every point source which discharges pollutants into waters of the United States must obtain a National Pollutant Discharge Elimination System ("NPDES") permit specifying the allowable quantity and characteristics of the pollutants discharged. TVA's various point sources have received NPDES permits, including all of its major generating units. Compliance with NPDES requirements has necessitated substantial expenditures and may require additional expenditures in the future as NPDES permits come up for renewal and applicable requirements become more stringent.

The CWA allows the permitting authority to establish thermal limits less stringent than the water quality criteria if the discharger can demonstrate that the alternate limit will assure protection and propagation of a balanced, indigenous aquatic population. TVA has now been issued alternate limits at several of its facilities, and it is meeting these limits. The CWA also requires that the design, capacity, location and construction of cooling water intake structures reflect the best technology available for minimizing adverse environmental impacts. EPA has a rulemaking underway that would address the design of water intake structures at new and existing facilities. The rulemaking for existing facilities is not expected to be completed for several years but could require changes to be made at TVA facilities. The cost of such changes is uncertain.

Solid and Hazardous Waste Management

Under the Resource Conservation and Recovery Act ("RCRA"), the storage, transportation and disposal of hazardous wastes are regulated by EPA and the states. RCRA also allows EPA and the states to regulate solid wastes, and the states have detailed permitting programs for this. TVA has detailed procedures in place designed to ensure compliance with all applicable requirements for the management of hazardous wastes. Additionally, TVA has instituted an approved supplier list for hazardous waste disposal contractors under which such contractors' financial status, compliance history and physical facilities and operations can be reviewed before they are allowed to treat or dispose of any of the hazardous wastes generated by TVA facilities. TVA does not itself operate any hazardous waste disposal or treatment facilities but does operate a permitted hazardous waste storage facility in Muscle Shoals, Alabama. TVA maintains solid waste disposal permits for the solid waste disposal areas (e.g., fly ash, scrubber sludge, demolition materials and asbestos) it operates at some of its plant sites. TVA's costs in this area have not been substantial, but applicable requirements change frequently and are expected to become more stringent.

Under the Comprehensive Environmental Response, Compensation, and Liability Act ("CERCLA"), the release and cleanup of hazardous substances are regulated. Liability under CERCLA is generally viewed as joint and several, and TVA estimates its share of cleanup costs under CERCLA to be less than $100,000.

Miscellaneous

Polychlorinated biphenyls ("PCBs") have been widely used as insulating fluids in electric equipment such as transformers and capacitors. Use of this equipment and the cleanup of released PCBs are regulated by EPA under the Toxic Substances Control Act. The TVA power system uses thousands of pieces of equipment that contain some level of PCBs. These pieces of equipment, when maintained properly, may continue to be operated under EPA's PCB regulations for the remainder of their useful lives. However, TVA has been phasing out much of this equipment as a matter of policy. The cost of phasing out the remainder of this equipment cannot be accurately determined at this time, but is not expected to be substantial. TVA has detailed procedures in place to conform its operations to EPA's PCB regulations and has not incurred substantial costs in this area.

There is public concern about whether there are adverse health effects from exposure to electric and magnetic fields ("EMF"). There are many sources of EMF, including electric transmission lines. Certain research, including a report by a National Academy of Sciences organization, has not found conclusive evidence that EMF causes adverse health effects. Other research, such as a report by the National Institute of Environmental Health Sciences, has found limited evidence that certain types of exposure to EMF are carcinogenic. Research in this area continues. Substantial costs could be incurred by electric systems, including TVA, if EMF levels from transmission lines have to be reduced, but this appears unlikely at this time.

INSURANCE

TVA does not generally carry property damage or public liability insurance except (1) as may be required or appropriate with respect to nuclear facilities and (2) to the extent it may do so as part of an owner-controlled insurance program it has implemented for some large contracts requiring on-site labor. The Federal Employees' Compensation Act governs liability for service-connected injuries to employees. See "Nuclear Power Program" — "Nuclear Insurance" herein and note 9 of the accompanying Financial Statements for additional information with respect to insurance.

PENDING LITIGATION

EPA has issued TVA an administrative order directing TVA to put "new-source" controls on 14 of its units and to evaluate whether more controls should be installed on other units. TVA has challenged the validity of this order. See "Environmental Matters" — "Air Pollution" for a further discussion of this order.

TVA is a party to various other civil lawsuits and claims that have arisen in the ordinary course of its business. Although the outcome of these other civil lawsuits and claims cannot be predicted with any certainty, it is the opinion of TVA counsel that their ultimate outcome should not have a material adverse effect on TVA's financial position or results of operations.

MANAGEMENT

TVA is administered by a board of directors composed of three persons appointed by the President and confirmed by the Senate. The Board and selected officers, their ages, their years of employment with TVA and principal occupations for recent years are as follows:

Name and Title	Age	Year Commenced Employment	Year Term Expires
Craven Crowell Chairman	57	1993	2002
Skila Harris Director	50	1999	2008
Glenn L. McCullough, Jr. Director	46	1999	2005
Oswald J. Zeringue President and Chief Operating Officer	55	1989	
John A. Scalice Chief Nuclear Officer & Executive Vice President, TVA Nuclear	53	1989	
David N. Smith Chief Financial Officer & Executive Vice President, Financial Services	56	1995	
Maureen H. Dunn Executive Vice President and General Counsel	51	1978	

Mr. Crowell was appointed to the Board in July 1993. Prior to his current position, he served as Chief of Staff for Jim Sasser, Tennessee's then-senior United States Senator (1989-1993), as Vice President of TVA's Office of Governmental & Public Affairs (1988-1989) and as TVA's Director of Information (1980-1988). Mr. Crowell has announced his intention to retire from TVA in April 2001.

Ms. Harris was appointed to the Board in November 1999. Prior to her current position, she served at DOE as Executive Director of the Secretary of Energy Advisory Board. From 1993 until 1997, she was a Special Assistant to Vice President Gore and Mrs. Gore's Chief of Staff. She came to the White House from Steiner-Liff Iron and Metal Company in Nashville, Tennessee, where she was Vice President for Development and Compliance. Ms. Harris served as a project manager at the U.S. Synthetic Fuels Corporation, and she was with DOE during the Carter Administration. She has also held positions with management and engineering consulting firms specializing in energy-related work.

Mr. McCullough was appointed to the Board in November 1999, having served as the mayor of Tupelo, Mississippi, since 1997. Prior to his election as mayor of Tupelo, he was the director of the Mississippi office of the Appalachian Regional Commission. Director McCullough also worked in the family business, McCullough Steel Products, for 12 years.

Mr. Zeringue was named President and Chief Operating Officer in April 1998. Prior to his current position, he served as Chief Nuclear Officer & Executive Vice President (1997-1998), as Senior Vice President, Nuclear Operations (1993-1997), as Browns Ferry Site Vice President (1989-1993) and as Plant Manager of Palo Verde Nuclear Station, Arizona Public Service Company (1987-1989).

Mr. Scalice was named Chief Nuclear Officer & Executive Vice President, TVA Nuclear in June 1998. Prior to his current position, he served as Acting Chief Nuclear Officer (beginning April 1998), as Senior Vice President of Nuclear Operations (1997-1998), as Watts Bar Site Vice President (1993-1997), as Plant Manager of Browns Ferry Nuclear Plant (1991-1993), as Plant Manager of Watts Bar Nuclear Plant (1989-1991) and as Plant Manager of Shoreham Nuclear Power Station, Long Island Lighting Company (1989).

Mr. Smith was named Chief Financial Officer in January 1995 and additionally was named Executive Vice President, Financial Services, in October 1996. Prior to his current position, he served as Executive Director of Odyssey Financial (1993-1994), as Vice President of Finance of LTV Corporation (1991-1993) and as Assistant Treasurer and Director of Corporate Finance of LTV Corporation (1986-1991).

Ms. Dunn joined TVA as an attorney in May 1978, assumed the position of Assistant General Counsel in September 1986, and assumed the position of Executive Vice President and General Counsel in January 2001.

EMPLOYEES

On September 30, 2000, TVA had about 13,145 employees, of which approximately 5,000 were trades and labor employees. Neither the federal labor relations laws covering most private sector employers nor those covering most federal agencies apply to TVA. However, the Board has a long-standing policy of recognizing and dealing with recognized representatives of its employees and currently has collective bargaining agreements in place covering each of its bargaining units. Federal law prohibits TVA employees from engaging in strikes against TVA.

Salaries of regular TVA employees are limited by a federal pay cap (Executive Level IV, currently $125,700). The federal pay cap makes it a challenge for TVA to recruit and retain top management talent. In response, TVA has developed and implemented supplementary compensation arrangements to reduce the impact of the pay cap and to enhance TVA's ability to attract and retain the caliber of executive talent required to manage one of the largest power systems in the country. TVA believes the implementation of these arrangements is within its legal authority. In the past, the General Accounting Office ("GAO") has expressed the opinion that some of TVA's compensation arrangements are not within TVA's legal authority. However, GAO has no authority to issue binding legal opinions on this matter or to stop any TVA payments. Congress has been aware of TVA's supplemental compensation arrangements and has not taken any action that would undermine TVA's position that the arrangements are within its legal authority.

In October 1995, the President issued an Executive Order requiring government corporations, including TVA, to submit information to the Office of Management and Budget ("OMB") on bonuses paid to its senior executives. TVA submits information on these bonuses annually to OMB and also publicly disseminates this information. OMB approval of TVA's bonuses is not required.

CERTAIN PROVISIONS OF THE TENNESSEE VALLEY AUTHORITY ACT

The following summary of certain provisions of the Act is ***not complete*** *and is qualified in its entirety by reference to the full text of the Act.*

Payments in Lieu of Taxes

TVA is not subject to federal income taxes or to taxation by states or their subdivisions. However, the Act requires TVA to make payments in lieu of taxes to states and counties in which the Corporation conducts power operations. The basic amount of these payments is 5 percent of gross revenues from the sale of power to entities other than federal agencies during the preceding year, with a provision for minimum payments under certain circumstances.

Payments to the Treasury

The Act requires TVA to make certain payments to the Treasury each year from Net Power Proceeds in excess of those required for debt service, as a return on and reduction of the Appropriation Investment. The Appropriation Investment totaled $523 million as of December 31, 2000. Net Power Proceeds are defined as the remainder of gross power revenues from TVA's power program

after deducting

- the costs of operating, maintaining and administering its power properties (including multiple-purpose properties in the proportion that multiple-purpose costs are allocated to power) and
- payments to states and counties in lieu of taxes,

but before deducting

- depreciation accruals or other charges representing the amortization of capital expenditures,

plus

- the net proceeds of the sale or other disposition of any interest in TVA's power properties that constitute an operating unit or system.

Acquisition of Real Estate

The Act empowers TVA to acquire real estate in the name of the United States of America by purchase or by exercise of the right of eminent domain, "and thereupon all such real estate shall be entrusted to the Corporation as the agent of the United States to accomplish the purposes of [the] Act." Thus, you should read and construe all references in this Statement to TVA properties, and to the amounts invested in TVA properties, in the light of this provision of the Act.

THE BASIC RESOLUTION; POWER BONDS, DISCOUNT NOTES AND OTHER INDEBTEDNESS

TVA issues Power Bonds pursuant to Section 15d of the Act and pursuant to the Basic Resolution. At December 31, 2000, TVA had U.S. $20.8 billion, DM 1.5 billion (issued in September 1996) and £200 million (issued in December 1998) principal amount of Power Bonds outstanding. TVA may issue Power Bonds only to provide capital for TVA's power program (including refunding any Evidences of Indebtedness issued for like purposes) and only as authorized by law at the time of issuance. Power Bonds are payable as to both principal and interest solely from Net Power Proceeds, but TVA may, at its option, pay Power Bonds from the proceeds of refunding obligations or other funds legally available for such payment. *Power Bonds are not obligations of, or guaranteed by, the United States of America.* Net Power Proceeds for fiscal 2000, 1999 and 1998 were $3.0 billion, $3.1 billion and $3.2 billion, respectively. Power Bonds of each series must be further authorized by Supplemental Resolution.

TVA intends from time to time to issue new Power Bonds with maturities and on terms determined in light of market conditions at the time of sale. TVA may sell new Power Bonds to dealers or underwriters, who may resell the new Power Bonds in public offerings or otherwise. Additionally, TVA may sell new Power Bonds directly or through other entities.

The offering circular, and any appropriate amendment or supplement to the offering circular, for each offering of new Power Bonds, except for new Power Bonds offered under a program on a continuous basis, will set forth the following information: (1) the aggregate principal amount, (2) maturity, (3) interest rate or method for determining such rate, (4) interest payment dates, if any, (5) purchase price to be paid to TVA, (6) any terms for redemption or other special terms, (7) form and denomination of new Power Bonds, (8) information as to any stock exchange listing, (9) the names of any dealers, underwriters or agents, (10) a description of any amendments or supplements to the Basic Resolution in connection with the sale of the new Power Bonds and (11) other terms of the new Power Bonds.

For Power Bonds offered under a program on a continuous basis, TVA will prepare a single offering circular that describes the general terms and conditions common to all Power Bonds issued under the program. The offering circular will describe how, if at all, the offering circular will be supplemented in order to reflect, among other things, the specific terms and conditions of the Power Bonds being offered. At the time of each sale, TVA will determine if the Power Bonds being sold will be subject to redemption prior to the maturity date and will establish the purchase price, principal amount, interest rate or interest rate formula, maturity date and certain other terms of such sale.

TVA also issues Discount Notes pursuant to Section 15d of the Act and in accord with Section 2.5 of the Basic Resolution. As of December 31, 2000, TVA had approximately $2.4 billion in Discount Notes outstanding. Discount Notes are payable solely from Net Power Proceeds, but TVA may, at its option, pay Discount Notes from the proceeds of refunding obligations or other funds legally available for such payment. *Discount Notes are not obligations of, or guaranteed by, the United States of America.* TVA intends to offer Discount Notes for sale on a continuous basis to a group of securities dealers selected by TVA, who will resell the notes. TVA will issue Discount Notes in a form and upon terms and conditions as it deems appropriate. Certain information respecting Discount Notes will be set forth in a Discount Notes offering circular and any appropriate supplement to the offering circular.

TVA from time to time may issue Other Indebtedness, in addition to new Power Bonds and Discount Notes, to assist in financing its Power Program. TVA issues Other Indebtedness, such as Quarterly Income Debt Securities ("QIDS"), pursuant to Section 15d of the Act and under appropriate authorizing resolutions. At December 31, 2000, TVA had outstanding $1.1 billion principal amount of QIDS. TVA may issue subordinated debt securities, such as QIDS, from time to time with maturities and on terms determined in light of market conditions at the time of sale. TVA may sell subordinated debt securities to dealers or underwriters, who may resell them in public offerings or otherwise. Additionally, TVA may sell subordinated debt securities directly or through other entities. TVA subordinated debt securities will be payable as to both principal and interest solely from Net Power Proceeds, but TVA may, at its option, pay subordinated debt securities from the proceeds of refunding obligations or other funds legally available for such payment. *Subordinated debt securities are not obligations of, or guaranteed by, the United States of America.*

An offering circular, and any appropriate amendment or supplement to the offering circular, for each offering of Other Indebtedness will set forth the following information: (1) the aggregate principal amount, (2) maturity, (3) interest rate or method for determining such rate, (4) interest payment dates, if any, (5) purchase price to be paid to TVA, (6) any terms for redemption or other special terms, (7) form and denomination of Other Indebtedness, (8) information as to any stock exchange listing, (9) the names of any dealers, underwriters or agents and (10) other terms of Other Indebtedness. *Other Indebtedness will not be obligations of, or guaranteed by, the United States of America.*

The following summary of certain provisions of the Basic Resolution is ***not complete*** *and is qualified in its entirety by reference to the full text of the Basic Resolution. See also "Public Law No. 105-62."*

Application of Net Power Proceeds

Section 2.3 of the Basic Resolution provides as follows:

> Net Power Proceeds shall be applied, and the Corporation hereby specifically pledges them for application, first to payments due as interest on Bonds, on Bond Anticipation Obligations, and on any Evidences of Indebtedness issued pursuant to Section 2.5 which rank on a parity with Bonds as to interest; to payments of the principal due on Bonds for the payment of which other provisions have not been made and on any Evidences of Indebtedness issued pursuant to Section 2.5 which rank on a parity with Bonds as to principal and for the payment of which other provisions have not been made; and to meeting requirements of sinking funds or other analogous funds under any Supplemental Resolutions. The remaining Net Power Proceeds shall be used only for:
>
> (a) Required interest payments on any Evidences of Indebtedness issued pursuant to Section 2.5 which do not rank on a parity with Bonds as to interest.
>
> (b) Required payments of or on account of principal of any Evidences of Indebtedness which do not rank on a parity with Bonds as to principal.
>
> (c) Minimum payments into the United States Treasury required by the Act in repayment of and as a return on the Appropriation Investment.
>
> (d) Investment in Power Assets, additional reductions of the Corporation's capital obligations, and other lawful purposes related to the Power Program; provided, however, that payments into the United States Treasury in any fiscal year in reduction of the Appropriation Investment in addition to the minimum amounts required for such purpose by the Act may be made only if there is a net reduction during such year in the dollar amount of outstanding Evidences of Indebtedness issued for capital purposes, and only to such extent that the percentage of aggregate reduction in the Appropriation Investment during such year does not exceed the percentage of net reduction during the year in the dollar amount of outstanding Evidences of Indebtedness issued for capital purposes.

Section 2.4 of the Basic Resolution provides as follows:

> The Corporation, having first adopted a Supplemental Resolution authorizing the issuance of a series of Bonds and pending such issuance, may issue Bond Anticipation Obligations and renewals thereof (including Interim Obligations to the Secretary of the Treasury) to be paid from the proceeds of such series of Bonds when issued or from other funds that may be available for that purpose.

Section 2.5 of the Basic Resolution provides as follows:

> To assist in financing its Power Program the Corporation may issue Evidences of Indebtedness other than Bonds and Bond Anticipation Obligations, which may be payable out of Net Power Proceeds subject to the provisions of Section 2.3 hereof. Such other Evidences of Indebtedness may rank on a parity with but shall not rank ahead of the Bonds as to payments on account of the principal thereof or the interest thereon.

See "Public Law No. 105-62" for a discussion of legislation relating to appropriations for TVA's nonpower programs and the funding of such programs, including the use of power revenues.

Rate Covenant

Section 3.2 of the Basic Resolution provides as follows:

> The Corporation shall fix, maintain, and collect rates for power sufficient to meet in each fiscal year the requirements of that portion of the present subsection (f) of section 15d of the Act which reads as follows:
>
> The Corporation shall charge rates for power which will produce gross revenues sufficient to provide funds for operation, maintenance, and administration of its power system; payments to States and counties in lieu of taxes; debt service on outstanding bonds, including provision and maintenance of reserve funds and other funds established in connection therewith; payments to the Treasury as a return on the appropriation investment pursuant to subsection (e) hereof; payment to the Treasury of the repayment sums specified in subsection (e) hereof; and such additional margin as the Board may consider desirable for investment in power system assets, retirement of outstanding bonds in advance of maturity, additional reduction of appropriation investment, and other purposes connected with the Corporation's power business, having due regard for the primary objectives of the Act, including the objective that power shall be sold at rates as low as are feasible.
>
> For purposes of this Resolution, "debt service on outstanding bonds," as used in the above provision of the Act, shall mean for any fiscal year the sum of all amounts required to be (a) paid during such fiscal year as interest on Evidences of Indebtedness, (b) accumulated in such fiscal year in any sinking or other analogous fund provided for in connection with any Evidences of Indebtedness, and (c) paid in such fiscal year on account of the principal of any Evidences of Indebtedness for the payment of which funds will not be available from sinking or other analogous funds, from the proceeds of refunding issues, or from other sources; provided, however, that for purposes of clause (c) of this definition Bond Anticipation Obligations and renewals thereof shall be deemed to mature in the proportions and at the times provided for paying or setting aside funds for the payment of the principal of the authorized Bonds in anticipation of the issuance of which such Bond Anticipation Obligations were issued.
>
> The rates for power fixed by the Corporation shall also be sufficient so that they would cover all requirements of the above-quoted provision of subsection (f) of section 15d of the Act if, in such requirements, there were substituted for "debt service on outstanding bonds" for any fiscal year the amount which if applied annually for 35 years would retire, with interest at the rates applicable thereto, the originally issued amounts of all series of Bonds and other Evidences of Indebtedness, any part of which was outstanding on October 1 of such year.

Covenant for Protection of Bondholders' Investment

Under the Act and Section 3.3 of the Basic Resolution, TVA must, in each successive five-year period beginning October 1, 1960, use an amount of Net Power Proceeds at least equal to the sum of (1) depreciation accruals and other charges representing the amortization of capital expenditures and (2) the net proceeds from any disposition of power facilities for either (a) the reduction of its capital obligations (including Evidences of Indebtedness and the Appropriation Investment) or (b) investment in Power Assets.

Issuance of Additional Bonds and Other Evidences of Indebtedness

The Act limits the issuance of Evidences of Indebtedness by TVA to a total of $30 billion outstanding at any one time. At December 31, 2000, TVA had approximately U.S.$24.3 billion, DM1.5 billion (issued in September 1996) and £200 million (issued in December 1998) of Evidences of Indebtedness outstanding. The Basic Resolution and the Act permit the issuance of Power Bonds only to provide capital for TVA's power program, including the refunding of any Evidences of Indebtedness issued for that purpose.

Power Bonds, the terms and conditions of which may not be inconsistent with the Basic Resolution, must also be authorized by Supplemental Resolution. The Basic Resolution provides that each Supplemental Resolution authorizing the issuance of Power Bonds must contain a finding by the Board that after the authorized Power Bonds have been issued, gross revenues from TVA's power program will be adequate to meet the requirements of the Basic Resolution with respect to rates and the application of depreciation accruals. These requirements are described under "The Basic Resolution; Power Bonds, Discount Notes and Other Indebtedness" — "Rate Covenant" and "Covenant for Protection of Bondholders' Investment."

Pending the issuance of Power Bonds authorized by a Supplemental Resolution, TVA may issue Bond Anticipation Obligations and renewals of Bond Anticipation Obligations (including Interim Obligations to the Secretary of the Treasury), to be paid from the proceeds of such Power Bonds when issued or from other funds that may be available for that purpose.

TVA may also issue Evidences of Indebtedness other than Power Bonds and Bond Anticipation Obligations, such as Discount Notes, to assist in financing TVA's power program. They may be payable out of Net Power Proceeds subject to the provisions of Section 2.3 of the Basic Resolution. They may not rank ahead of the Power Bonds as to principal or interest.

Mortgaging and Disposal of Power Properties

TVA may not mortgage any part of its power properties and may not dispose of all or any substantial portion of these properties unless it provides for a continuance of the interest, principal and sinking fund payments due and to become due on all outstanding Evidences of Indebtedness, or for the retirement of such Evidences of Indebtedness.

Modifications of Resolutions and Outstanding Bonds

The Basic Resolution provides for amendments to it, to any Supplemental Resolution and to any outstanding Power Bonds. Generally, TVA may make amendments to the respective rights and obligations of TVA and the bondholders with the written consent of the holders of at least $66\frac{2}{3}$ percent in principal amount of the outstanding Power Bonds to which the amendment applies. However, TVA may not make changes in the maturity, principal amount, redemption premium or rate of interest or maturity of any interest installment, with respect to any Power Bond, or in the above percentage for any such consent, without the consent of the holder of such Power Bond.

Additionally, TVA may amend the Basic Resolution or any Supplemental Resolution without the consent of the bondholders in order (1) to close the Basic Resolution against the issuance of additional Power Bonds or to restrict such issuance by imposing additional conditions or restrictions; (2) to add other covenants and agreements to be observed by TVA or to eliminate any right, power or privilege conferred upon TVA by the Basic Resolution; (3) to modify any provisions to release TVA from any of its obligations, covenants, agreements, limitations, conditions or restrictions, provided that such modification or release shall not become effective with respect to any Power Bonds issued prior to the adoption of such amendment; (4) to correct any defect, ambiguity or inconsistency in, or to make provisions in regard to matters or questions arising under, the Basic Resolution or any Supplemental Resolution, so long as such amendments are not contrary to, or inconsistent with, the Basic Resolution or such Supplemental Resolution; or (5) to make any other modification or amendment which the Board by resolution determines will not materially and adversely affect the interests of holders of the Power Bonds.

Events of Default

Any of the following shall be deemed an Event of Default under the Basic Resolution: (1) default in the payment of the principal or redemption price of any Power Bond when due and payable at maturity, by call for redemption, or otherwise; (2) default in the payment of any installment of interest on any Power Bond when due and payable for more than 30 days; or (3) failure of TVA to duly perform any other covenant, condition or agreement contained in the Power Bonds or in the Basic Resolution or any Supplemental Resolution for 90 days after written notice specifying such failure has been given to TVA by the holders of at least 5 percent in aggregate principal amount of the then-outstanding Power Bonds.

Upon any such Event of Default, the holders of the Power Bonds may proceed to protect and enforce their respective rights, subject to the restrictions described below. The holders of at least 5 percent in aggregate principal amount of Power Bonds then outstanding shall, subject to certain restrictions, have the right and power to institute a proceeding (1) to enforce TVA's covenants and agreements, (2) to enjoin any acts in violation of the rights of holders of Power Bonds and (3) to protect and enforce the rights of holders of Power Bonds. Power Bonds do not provide for acceleration upon an Event of Default. Such holders have no right to bring any such action or proceeding against TVA unless they have given TVA written notice of an Event of Default and TVA has had a reasonable opportunity to take appropriate corrective action with respect thereto and has failed or refused to do so.

Holders of a majority in aggregate principal amount of the outstanding Power Bonds have the right to direct the time, method and place of conducting any proceeding for any remedy available and may waive any default and its consequences, except a default in the payment of the principal of or premium, if any, or interest on any Power Bonds.

Fourth Amendatory Resolution to the Basic Resolution

On March 25, 1992, TVA adopted a resolution amending the Basic Resolution, entitled "Fourth Amendatory Resolution to Basic Tennessee Valley Authority Power Bond Resolution" (the "Fourth Amendatory Resolution"), that (1) deleted from the Basic Resolution limitations on issuance of Power Bonds formerly set forth as Section 3.4 thereof and (2) amended the Basic Resolution to permit issuance of other Evidences of Indebtedness under Section 2.5 thereof that rank on a parity with Power Bonds as to principal and interest. With the deletion of Section 3.4 of the Basic Resolution, Sections 3.5 through 3.10 were renumbered as appropriate.

PUBLIC LAW NO. 105-62

In October 1997 Congress enacted the Energy and Water Development Appropriations Act, 1998, Pub. L. No. 105-62, 111 Stat. 1320, 1338 (1997). The paragraph captioned "TENNESSEE VALLEY AUTHORITY" in Title IV of this act (the "Appropriations Act paragraph") requires TVA, beginning with October 1, 1998, to fund nonpower programs that constitute "essential stewardship activities" with revenues derived from one or more of various sources, including power revenues, notwithstanding provisions of the TVA Act and power bond covenants to the contrary.

The Appropriations Act paragraph states:

> For the purpose of carrying out the provisions of the Tennessee Valley Authority Act of 1933, as amended (16 U.S.C. ch. 12A), including hire, maintenance, and operation of aircraft, and purchase and hire of passenger motor vehicles, \$70,000,000, to remain available until expended, of which \$6,900,000 shall be available for operation, maintenance, surveillance, and improvement of Land Between the Lakes; and for essential stewardship activities for which appropriations were provided to the Tennessee Valley Authority in Public Law 104-206, such sums as are necessary in fiscal year 1999 and thereafter, to be derived only from one or more of the following sources: nonpower fund balances and collections; investment returns of the nonpower program; applied programmatic savings in the power and nonpower programs; savings from the suspension of bonuses and awards; savings from reductions in memberships and contributions; increases in collections resulting from nonpower activities, including user fees; or increases in charges to private and public utilities both investor and cooperatively owned, as well as to direct load customers: *Provided,* That such funds are available to fund the stewardship activities under this paragraph, notwithstanding sections 11, 14, 15, 29, or other provisions of the Tennessee Valley Authority Act, as amended, or provisions of the TVA power bond covenants: *Provided further,* That the savings from, and revenue adjustments to, the TVA budget in fiscal year

1999 and thereafter shall be sufficient to fund the aforementioned stewardship activities such that the net spending authority and resulting outlays for these activities shall not exceed $0 in fiscal year 1999 and thereafter.

Congress provided no appropriations for TVA's nonpower programs for fiscal 2000. In compliance with the Appropriations Act, TVA is and will continue funding its essential stewardship activities with funds from its power program (and other available funds) to the extent that Congress does not make appropriations for these activities.

INDEPENDENT ACCOUNTANTS

The financial statements of TVA at September 30, 2000 and 1999, and for each of the three fiscal years in the period ended September 30, 2000, appended hereto as part of this Statement, have been audited by PricewaterhouseCoopers LLP, independent accountants, as set forth in their report, dated October 24, 2000, which report is also appended hereto.

* * * * *

Any statements in this Statement involving matters of opinion, regardless of whether expressly so identified, are opinions only and not factual representations. This Statement is not a contract with the purchaser of any of the New Power Bonds, Discount Notes or Other Indebtedness.

This Statement has been approved by a duly authorized officer of the Tennessee Valley Authority.

Tennessee Valley Authority

By: /s/ JOHN M. HOSKINS

John M. Hoskins

Senior Vice President and Treasurer

Dated February 8, 2001

TENNESSEE VALLEY AUTHORITY

FINANCIAL STATEMENTS

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FINANCIAL STATEMENTS

BALANCE SHEETS
At September 30

	Power program 2000	Power program 1999	All programs 2000	All programs 1999
	(in millions)			
ASSETS				
Current Assets				
Cash and cash equivalents	$ 348	$ 103	$ 361	$ 160
Accounts receivable	688	730	688	730
Inventories at average cost and other				
Fuel	141	178	141	178
Other	249	307	249	307
Total current assets	1,426	1,318	1,439	1,375
Property, Plant and Equipment				
Completed plant	30,157	29,569	31,189	30,685
Less accumulated depreciation	(9,520)	(8,762)	(9,813)	(9,074)
Net completed plant	20,637	20,807	21,376	21,611
Construction in progress	793	730	793	730
Deferred nuclear generating units	6,325	6,320	6,325	6,320
Nuclear fuel and capital leases	559	560	559	560
Total property, plant, and equipment	28,314	28,417	29,053	29,221
Investment Funds	840	731	840	731
Deferred Charges and Other Assets				
Loans and other long-term receivables	144	122	176	153
Debt issue and reacquisition costs	1,302	1,188	1,302	1,188
Other deferred charges	1,155	1,610	1,155	1,610
Total deferred charges and other assets	2,601	2,920	2,633	2,951
Total assets	$33,181	$33,386	$33,965	$34,278
LIABILITIES AND PROPRIETARY CAPITAL				
Current Liabilities				
Accounts payable	$ 531	$ 493	$ 544	$ 521
Accrued liabilities	200	178	200	182
Accrued interest	438	464	438	464
Discount notes	1,274	982	1,274	982
Current maturities of long-term debt	2,350	1,000	2,350	1,000
Total current liabilities	4,793	3,117	4,806	3,149
Other Liabilities	2,455	2,156	2,455	2,156
Long-Term Debt				
Public bonds — senior	21,261	23,294	21,261	23,294
Public bonds — subordinated	1,100	1,100	1,100	1,100
Unamortized discount and other adjustments	(608)	(491)	(608)	(491)
Total long-term debt	21,753	23,903	21,753	23,903
Proprietary Capital				
Appropriation investment	528	548	4,883	4,964
Retained earnings reinvested in power program	3,652	3,662	3,652	3,662
Accumulated net expense of nonpower programs	—	—	(3,584)	(3,556)
Total proprietary capital	4,180	4,210	4,951	5,070
Total liabilities and proprietary capital	$33,181	$33,386	$33,965	$34,278

The accompanying notes are an integral part of these financial statements.

FINANCIAL STATEMENTS

STATEMENTS OF INCOME — POWER PROGRAM
For the Years Ended September 30

	2000	1999	1998
		(in millions)	
Operating Revenues			
Sales of electricity			
Municipalities and cooperatives	$5,676	$5,510	$5,554
Industries directly served	626	642	523
Federal agencies and other	361	357	556
Other revenue	99	86	96
Total operating revenues	6,762	6,595	6,729
Operating Expenses			
Fuel and purchased power	1,962	1,777	1,900
Operating and maintenance	1,443	1,403	1,347
Depreciation and amortization	1,185	1,181	1,038
Tax-equivalents	308	304	264
Accelerated amortization (notes 1 and 7)	121	261	—
Total operating expenses	5,019	4,926	4,549
Operating Income	1,743	1,669	2,180
Other income, net	17	10	12
Income before interest expense and cumulative effect of change in accounting principle	1,760	1,679	2,192
Interest Expense			
Interest on debt	1,695	1,753	1,930
Amortization of debt discount, issue and reacquisition costs, net	94	60	84
Allowance for funds used during construction	(53)	(36)	(55)
Net interest expense	1,736	1,777	1,959
Cumulative effect of change in accounting principle (notes 1 and 7)	—	217	—
Net Income	$ 24	$ 119	$ 233

The accompanying notes are an integral part of these financial statements.

FINANCIAL STATEMENTS

STATEMENTS OF CASH FLOWS
For the Years Ended September 30

	Power program			All programs		
	2000	1999	1998	2000	1999	1998
	(in millions)					
Cash Flows from Operating Activities						
Net power income	$ 24	$ 119	$ 233	$ 24	$ 119	$ 233
Net expense of nonpower programs	—	—	—	(28)	(96)	(91)
Items not requiring (providing) cash						
Depreciation and amortization	1,289	1,250	1,090	1,299	1,263	1,103
Accelerated amortization	121	261	—	121	261	—
Allowance for funds used during construction	(53)	(36)	(55)	(53)	(36)	(55)
Nuclear fuel amortization	177	177	264	177	177	264
Cumulative effect of change in accounting principle	—	(217)	—	—	(217)	—
Other, net	25	(26)	(2)	25	—	9
Changes in current assets and liabilities						
Accounts receivable	42	65	(95)	42	65	(89)
Inventories and other	19	(35)	(72)	19	(35)	(72)
Accounts payable and accrued liabilities	61	(19)	72	42	(21)	59
Accrued interest	(26)	(23)	(11)	(26)	(23)	(11)
Other, net	(95)	(85)	(30)	(95)	(85)	(36)
Net cash provided by operating activities	1,584	1,431	1,394	1,547	1,372	1,314
Cash Flows from Investing Activities						
Construction expenditures	(867)	(829)	(637)	(867)	(830)	(642)
Allowance for funds used during construction	53	36	55	53	36	55
Nuclear fuel	(184)	(135)	(151)	(184)	(135)	(151)
Other, net	(37)	(28)	(9)	(38)	(21)	(8)
Net cash used in investing activities	(1,035)	(956)	(742)	(1,036)	(950)	(746)
Cash Flows from Financing Activities						
Long-term debt						
Issues	2,250	4,506	4,625	2,250	4,506	4,625
Redemptions	(2,944)	(4,046)	(4,930)	(2,944)	(4,046)	(4,930)
Short-term borrowings, net	292	(775)	(394)	292	(775)	(394)
Proceeds from combustion turbine financing	300	—	—	300	—	—
Financing costs, net	(148)	(391)	199	(148)	(391)	199
Congressional appropriations	—	—	—	—	50	69
Payments to U.S. Treasury	(54)	(57)	(60)	(54)	(57)	(60)
Other, net	—	—	—	(6)	—	—
Net cash used in financing activities	(304)	(763)	(560)	(310)	(713)	(491)
Net change in cash and cash equivalents	245	(288)	92	201	(291)	77
Cash and cash equivalents at beginning of period	103	391	299	160	451	374
Cash and Cash Equivalents at End of Period	$ 348	$ 103	$ 391	$ 361	$ 160	$ 451

The accompanying notes are an integral part of these financial statements.

FINANCIAL STATEMENTS

POWER PROGRAM

STATEMENTS OF CHANGES IN PROPRIETARY CAPITAL
For the Years Ended September 30

	2000	1999	1998
		(in millions)	
Retained earnings reinvested at beginning of period	$3,662	$3,580	$3,387
Net income	24	119	233
Return on appropriation investment	(34)	(37)	(40)
Retained Earnings Reinvested at End of Period	3,652	3,662	3,580
Appropriation investment at beginning of period	548	568	588
Return of appropriation investment	(20)	(20)	(20)
Appropriation investment at end of period	528	548	568
Proprietary Capital at End of Period	$4,180	$4,210	$4,148

NONPOWER PROGRAMS

STATEMENTS OF NET EXPENSE
For the Years Ended September 30

	2000	1999	1998
		(in millions)	
Water and Land Stewardship	$26	$72	$65
Land Between The Lakes	—	19	8
Economic Development	2	5	8
Environmental Research Center	—	—	10
Net Expense (note 10)	$28	$96	$91

NONPOWER PROGRAMS

STATEMENTS OF CHANGES IN PROPRIETARY CAPITAL
For the Years Ended September 30

	2000	1999	1998
		(in millions)	
Proprietary capital at beginning of period	$860	$908	$930
Congressional appropriations	—	50	69
Net expense	(28)	(96)	(91)
Transfers to other Federal agencies (note 10)	(56)	—	—
Other, net	(5)	(2)	—
Proprietary Capital at End of Period	$771	$860	$908

The accompanying notes are an integral part of these financial statements.

NOTES TO FINANCIAL STATEMENTS

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

General

TVA is a wholly owned corporate agency and instrumentality of the United States. It was established by the TVA Act with the objective of developing the resources of the Tennessee Valley region in order to strengthen the regional and national economy and the national defense by providing: (1) an ample supply of power within the region, (2) navigable channels and flood control for the Tennessee River System, and (3) agricultural and industrial development and improved forestry in the region. TVA carries out these regional and national responsibilities in a service area that centers on Tennessee and parts of Alabama, Georgia, Kentucky, Mississippi, North Carolina and Virginia.

TVA's operations have historically been divided into two types of activities — the power program and the nonpower programs. Substantially all TVA revenues and assets are attributable to the power program. The power program has historically been separate and distinct from the nonpower programs and is required to be self-supporting from power revenues and proceeds from the issuance of debt. The power program receives no congressional appropriations and is required to make annual payments to the U.S. Treasury in repayment of, and as a return on, the government's appropriation investment in TVA power facilities. Until 2000 most of the funding for TVA's nonpower programs was provided by congressional appropriations. Certain nonpower activities are also funded by various revenues and user fees. See note 10 for a discussion related to current and future funding of TVA's nonpower programs.

Power rates are established by the TVA Board of Directors as authorized by the TVA Act. The Act requires TVA to charge rates for power that, among other things, will produce gross revenues sufficient to provide funds for operation, maintenance and administration of its power system; payments to states in lieu of taxes; and debt service on outstanding indebtedness.

Fiscal year

Unless otherwise indicated, years (2000, 1999, etc.) refer to TVA's fiscal years ended September 30.

Revenue

Revenues from power sales are recorded as power is delivered to customers. TVA accrues estimated unbilled revenues for power sales provided to customers for the period of time from the end of the billing cycle to month-end.

Off-system sales are presented in the accompanying Statements of Income-Power Program as a component of Sales of electricity — Federal agencies and other.

Property, plant and equipment, and depreciation

Additions to plant are recorded at cost, which includes direct and indirect costs and an allowance for funds used during construction. The cost of current repairs and minor replacements is charged to operating expense. Nuclear fuel is valued at the lower of cost or market using the average cost method for raw materials and the specific identification method for nuclear fuel in reactor. Amortization of nuclear fuel is calculated on a units-of-production basis and is included in fuel expense. The TVA Act requires TVA's Board of Directors to allocate the cost of completed multipurpose projects between the power and nonpower programs, subject to the approval of the President of the United States. The original cost of property retired, together with removal costs less salvage value, is charged to accumulated depreciation. Depreciation is generally computed on a straight-line basis over the estimated service lives of the various classes of assets. Depreciation expense expressed as a percentage of the average annual depreciable completed plant was 3.27 percent for 2000, 3.28 percent for 1999 and 3.23 percent for 1998.

Decommissioning costs

TVA recognizes as incurred all obligations related to closure and removal of its nuclear units. Earnings from decommissioning investments, amortization of the decommissioning regulatory asset and interest expense on the decommissioning liability are deferred *(see note 9 — Decommissioning costs)*.

In 2000 TVA performed calculations in accordance with Nuclear Regulatory Commission (NRC) revised guidelines. The studies resulted in a $209 million decrease in TVA's required decommissioning obligation which was recorded along with a corresponding reduction in the regulatory asset.

Allowance for funds used during construction

TVA capitalizes an allowance for funds used during construction. The allowance is applicable to construction in progress, excluding deferred nuclear generating units.

Other deferred charges

Other deferred charges primarily include prepaid pension costs and regulatory assets capitalized under the provisions of Statement of Financial Accounting Standards (SFAS) No. 71, *Accounting for the Effects of Certain Types of Regulation.*

Regulatory assets

At September 30, 2000, other deferred charges included total unamortized regulatory assets of $372 million of which $228 million represents a transition obligation for certain postemployment benefits and $144 million represents an additional obligation related to the closure and removal of nuclear units *(see note 1 — Decommissioning costs)*. At September 30, 1999, the unamortized balances of regulatory assets of $968 million included $343 million representing a transition obligation for certain postemployment benefits; $393 million representing an additional obligation related to the closure and removal of nuclear units *(see note 1 — Decommissioning costs)*; $221 million representing an overmarket portion of nuclear fuel; and $11 million representing TVA's portion of the costs for decommissioning the DOE's uranium enrichment facilities.

Effective for 1999 TVA reclassified an additional $332 million from nuclear fuel inventory to deferred charges. This regulatory asset was fully amortized in 2000 *(see note 1 — Accelerated amortization)*. The effect of this change was to increase 1999 expense by approximately $111 million and to increase 2000 expense by approximately $221 million.

Accrual for nuclear refueling outage costs

Also effective for 1999 TVA changed its method of accounting for nuclear refueling outage maintenance costs whereby such costs are deferred and amortized on a straight-line basis over the estimated period until the next refueling outage, rather than expensed as incurred. The effect of this change was to decrease 2000 and 1999 expense by $11 million and $63 million, respectively.

Investment funds

Investment funds consist primarily of trust funds designated to fund nuclear decommissioning requirements *(see note 9 — Decommissioning costs)*. These funds are invested in portfolios of securities generally designed to earn returns in line with overall equity market performance.

Debt issue and reacquisition costs

Effective for 1999 TVA changed its method of amortizing debt issue and reacquisition costs. Under the current policy, debt issue and reacquisition expenses, call premiums and other related costs are deferred and amortized (accreted) on a pooled straight-line basis over the weighted average life of TVA's debt portfolio. Prior to 1999 debt issue and reacquisition costs were separately amortized on a straight-line basis over the term of the related outstanding securities. The effect of the change was to decrease 2000 and 1999 expense approximately $23 million and $20 million, respectively.

TVA has incurred premiums related to certain advanced refundings and also received and paid premiums in connection with the monetization of certain call provisions. In accordance with regulatory practices, TVA has deferred these premiums and is amortizing such premiums on a pooled straight-line basis over the weighted average life of TVA's debt portfolio. The unamortized balances of such regulatory assets at September 30, 2000 and 1999 were $607 million and $641 million, respectively.

Tax-equivalents

The TVA Act requires TVA to make payments to states and local governments where the power operations of the corporation are conducted. The amount is 5 percent of gross revenues from the prior year's sale of power, excluding sales to other Federal agencies and interchange sales with other utilities, with a provision for minimum payments under certain circumstances.

Accelerated amortization

Effective for 1999 TVA adopted a new accounting policy whereby annual provisions for amortization of deferred charges will be adjusted as necessary in order to achieve certain earnings levels as set forth in resolutions adopted annually by the TVA Board of Directors in connection with the rate review process. The targeted earnings levels will be based on the earnings requirements of the TVA Act and the Basic TVA Power Bond Resolution *(see note 5 — Borrowing authority)*. Such adjustments may result in either contracting or extending the estimated amortization periods. The amortization of such assets is principally computed on a straight-line basis, over periods ranging from three to 15 years. As a result of surplus earnings levels in 2000 and 1999, TVA accelerated amortization of certain regulatory assets by $121 million and $261 million, respectively, under the policy.

Interest and capital costs

During 2000, 1999 and 1998 cash paid for interest on outstanding indebtedness (net of amount capitalized) was $1,669 million, $1,740 million and $1,886 million, respectively. In addition to paying interest on outstanding indebtedness, the TVA Act requires TVA to make annual payments to the U.S. Treasury. The annual Treasury payments represent a repayment of the original appropriation investment, along with a return on the appropriation investment *(see note 4)*.

Risk-management activities

TVA is exposed to market risk from changes in interest rates and currency exchange rates. To manage volatility relating to these exposures, TVA has entered into various derivative transactions, principally an interest rate swap agreement and foreign currency swap agreements *(see note 5 — Foreign currency transactions and interest rate swap)*. TVA is exposed to credit losses in the event of nonperformance by counterparties on the risk-management instruments. TVA monitors such risk and does not believe that there is a significant risk of nonperformance by any of the parties of these instruments. TVA's risk management policies allow the use of derivative financial instruments to manage financial exposures, but prohibit the use of these instruments for speculative or trading purposes.

TVA may engage in hedging activities using forwards, futures or options to hedge the impact of market fluctuations on energy commodity prices. As of September 30, 1999, TVA accounted for these transactions using the deferral method, and gains and losses were recognized in the accompanying financial statements when the related hedged transaction occurred. Effective October 1, 2000, TVA adopted SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities,* which requires that derivatives be reported at their fair market value on the statement of financial position. Qualifying derivative contracts consisted of various purchased option contracts and certain currency and interest rate swap agreements *(see note 5 — Foreign currency transactions and interest rate swap)*. In accordance with SFAS No. 133, these contracts qualify for cash-flow hedge treatment. Accordingly, the effective portion of gains and losses related to such contracts is reported in accumulated other comprehensive income, while the ineffective portion is recognized through the creation of a regulatory asset/liability. As of October 1, 2000, TVA determined the effective portion of the gains related to the derivative contracts to be approximately $51 million, which was recorded as a cumulative-effect type transition adjustment of accumulated other comprehensive income and approximately $0.3 million related to the ineffective portion (loss), which was recorded as a regulatory liability.

Cash and cash equivalents

Cash and cash equivalents include the cash available in commercial bank accounts and U.S. Treasury accounts, as well as short-term securities held for the primary purpose of general liquidity.

Such securities mature within three months from the date of acquisition.

Insurance

TVA is primarily self-insured for property loss, workers' compensation, general liability and automotive liability. TVA is also self-insured for health care claims for eligible active and retired employees. Consulting actuaries assist TVA in determining certain liabilities for self-insured claims. TVA maintains nuclear liability insurance and nuclear property, decommissioning and decontamination insurance with an outside party *(see note 9 — Nuclear insurance)*.

Management estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the related amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Other

Certain reclassifications have been made to the 1998 and 1999 financial statements to conform to the 2000 presentation.

2. NUCLEAR POWER PROGRAM

The nuclear power program at September 30, 2000, consists of nine units — five operating, three deferred and one inoperative — at four locations, with investments in property, plant and equipment as follows and in the status indicated:

	Operating units	Installed capacity (megawatts)	Completed plant, net	Construction in progress	Deferred	Fuel investment
			(dollars in millions)			
Browns Ferry*	2	2,380	$ 2,995	$ 25	$ —	$168
Sequoyah	2	2,442	1,920	44	—	125
Watts Bar	1	1,270	6,237	14	1,719	68
Bellefonte	—	—	—	—	4,606	—
Raw materials	—	—	—	—	—	18
Total	5	6,092	$11,152	$ 83	$6,325	$379

* Browns Ferry 1, an inoperative unit, is discussed below.

Browns Ferry 1 was taken off-line in 1985 for modifications and improvements and will continue to remain in an inoperative status until its ultimate disposition is determined. The undepreciated cost of Browns Ferry 1 of $60 million is included in net completed plant and is being depreciated as part of the recoverable cost of the plant over the remaining license period.

TVA has three units in deferred status. In 1988 TVA suspended construction activities on Watts Bar 2, and the unit is currently in lay-up. Bellefonte 1 and 2 were deferred in 1988 and 1985, respectively. Estimated 2001 expenditures for the three deferred units are limited to lay-up, maintenance and ensuring that options remain viable.

In December 1994 TVA determined it will not, by itself, complete Bellefonte 1 and 2 and Watts Bar 2 as nuclear units. TVA's integrated resource planning process identified as a viable option the conversion of the Bellefonte facility to a combined-cycle plant utilizing natural gas or gasified coal. In 1997 an independent team of technical and financial experts completed a feasibility study to evaluate options for the conversion of the Bellefonte Nuclear Plant to a fossil fuel-fired plant. The feasibility study concluded that one of the most economical fossil conversion strategies is to complete Bellefonte as a natural gas-fired combined-cycle plant. TVA also issued an Environmental Impact Statement (EIS) assessing the environmental impacts of various fossil conversion options. The EIS identified the natural gas-fired combined-cycle plant alternative as the preferred option. Bellefonte remains in a deferred status.

While the future decisions on TVA's deferred units will ultimately impact the method of cost recovery, the TVA Board has determined that it will establish rate adjustments and operating policies to seek full recovery of the cost of these units and compliance with the requirements of the TVA Act.

3. COMPLETED PLANT — POWER PROGRAM

Completed plant of the power program consists of the following at September 30:

	2000			1999		
	Cost	Accumulated depreciation	Net	Cost	Accumulated depreciation	Net
			(in millions)			
Fossil plants	$ 8,150	$3,616	$ 4,534	$ 7,983	$3,407	$ 4,576
Nuclear plants	14,719	3,567	11,152	14,705	3,142	11,563
Transmission	3,473	1,154	2,319	3,384	1,091	2,293
Hydro plants	1,517	536	981	1,486	514	972
Other	2,298	647	1,651	2,011	608	1,403
Total	$30,157	$9,520	$20,637	$29,569	$8,762	$20,807

4. APPROPRIATION INVESTMENT — POWER PROGRAM

The TVA Act requires TVA to make annual payments to the U.S. Treasury from net power proceeds as a return on the appropriations investment in the power system and as a repayment of that investment. The payments required by the TVA Act may be deferred under certain circumstances for not more than two years. TVA paid $20 million each year for 2000, 1999 and 1998 as a repayment of the appropriation investment. In addition, TVA paid $34 million to the U.S. Treasury in 2000 as a return on the appropriation investment, while paying $37 million in 1999 and $40 million in 1998. The return is based on the appropriation investment as of the beginning of the year and the computed average interest rate payable by the U.S. Treasury on its total marketable public obligations as of the same date (6.34 percent at September 30, 1999).

5. DEBT

Borrowing authority

The TVA Act authorizes TVA to issue bonds, notes and other evidences of indebtedness up to a total of $30 billion outstanding at any one time. TVA must meet certain financial tests that are contained in the TVA Act and the Basic TVA Power Bond Resolution. Debt service on these obligations, which is payable solely from TVA's net power proceeds, has precedence over the payment to the U.S. Treasury described in note 4.

Short-term debt

The weighted average rates applicable to short-term debt outstanding in the public market as of September 30, 2000 and 1999, were 6.53 percent and 5.30 percent, respectively. During 2000, 1999 and 1998 the maximum outstanding balances of short-term borrowings held by the public were (in millions) $3,943, $4,701 and $2,914, respectively, and the average amounts (and weighted average interest rates) of such borrowings were approximately (in millions) $2,628 (5.94 percent), $1,945 (5.01 percent) and $2,234 (5.58 percent), respectively.

Put and call options

Bond issues of $7.3 billion held by the public are redeemable in whole or in part, at TVA's option, on call dates ranging from the present to July 2020 at call prices ranging from 100 percent to 106.7

percent of the principal amount. Additionally, TVA has bond issues of $3.1 billion held by the public that are redeemable in whole or in part at the option of the respective bondholders as follows. One bond issue totaling $500 million, which matures in July 2045, is redeemable in 2001 by the bondholders. A second issue totaling $121 million, which matures in April 2036, is redeemable in 2006 at the option of the bondholders. A third issue totaling $1.5 billion, which matures in April 2036, is redeemable in 2006 at the option of the bondholders, and a fourth issue totaling $1.0 billion, which matures in May 2012, is redeemable in 2002 at the option of the bondholders. Each of these four issues is reported in the debt schedule with maturity dates corresponding to the earliest redeemable dates. Six additional issues totaling $500 million, with maturity dates ranging from 2005 to 2030, include a provision for a right of redemption upon the death of a beneficial owner in certain specified circumstances.

Additionally, TVA has two issues of Putable Automatic Rate Reset Securities (PARRS) outstanding. The bonds permit TVA, after a fixed-rate period of five years, to reset the coupon rate downward under certain market conditions. Investors have the option to redeem the bonds at par if and when the interest rate is reset. One PARRS issue totals $575 million, matures in June 2028 and has its first potential reset date in June 2003. The second issue of PARRS totals $525 million, matures in May 2029 and has its first potential reset date in May 2004.

Foreign currency transactions and interest rate swap

During 1996 TVA entered into a currency swap contract as a hedge for a foreign currency denominated debt transaction. TVA issued DM1.5 billion of bonds and swapped the cash flows for those of a U.S. dollar obligation of $1 billion. TVA also entered into a currency swap contract during 1999 as a hedge for a Sterling denominated debt transaction where TVA issued £200 million of bonds in that transaction. Any gains or losses on the debt instruments due to the foreign currency transactions are offset by losses or gains on the swap contracts. At September 30, 2000 and 1999, the currency transactions resulted in net deferred gains of $360 million and $182 million, respectively, which are included in the account "unamortized discount and other adjustments." The offsetting losses on the swap contracts are recorded as a deferred liability. If any loss/(gain) were to be incurred as a result of the early termination of a swap contract, any resulting charge/(income) would be amortized over the remaining life of the bond as a component of interest expense.

Additionally, in 1997 TVA issued $300 million of inflation-indexed accreting principal bonds. The 10-year bonds have a fixed coupon rate that is paid on the inflation-adjusted principal amount. TVA hedged its inflation exposure under the securities through a 10-year fixed interest rate swap agreement.

Debt outstanding at September 30, 2000 and 1999, consists of the following:

	2000	1999
	(in millions)	
Short-term debt		
Discount notes (net of discount)	$ 1,274	$ 982
Current maturities of long-term debt — 5.00% to 6.50%	2,350	1,000
Total short-term debt	3,624	1,982
Long-term debt		
Senior		
Maturing in 2001 — 5.00% to 6.50%	—	2,350
Maturing in 2002 — 6.00%	2,000	1,000
Maturing in 2003 — 6.125%	1,250	1,250
Maturing in 2004 — 5.00%	400	400
Maturing in 2005 — 6.375% to 7.150%	2,065	2,000
Maturing in years 2006 through 2044 — 5.375% to 8.250%	15,546	16,294
Subordinated		
Maturing in 2045 and 2046 — 7.50% to 8.00%	1,100	1,100
Total long-term debt	22,361	24,394
Unamortized discount and other adjustments	(608)	(491)
Net long-term debt	21,753	23,903
Total debt	$25,377	$25,885

6. FAIR VALUE OF FINANCIAL INSTRUMENTS

TVA uses the methods and assumptions described below to estimate the fair values of each significant class of financial instrument. The fair market value of the financial instruments held at September 30, 2000, may not be representative of the actual gains or losses that will be recorded when these instruments mature or if they are called or presented for early redemption.

Cash and cash equivalents and short-term debt

The carrying amount approximates fair value because of the short-term maturity of these instruments.

Investment funds

At September 30, 2000, these investments were classified as trading securities and carried at their fair value.

Loans and other long-term receivables

Fair values for these homogeneous categories of loans and receivables are estimated by determining the present value of future cash flows using a discount rate equal to lending rates for similar loans made to borrowers with similar credit ratings and for the same remaining maturities.

Long-term debt

Fair value of long-term debt traded in the public market is determined by multiplying the par value of the bonds by the quoted market price (asked price) nearest the balance sheet date.

Other financing obligations

In September 2000 TVA received approximately $300 million in proceeds by entering into a lease-lease back transaction for eight new peaking combustion turbine units. Due to the nature of the recent refinancing transaction, the carrying amount of the obligation and fair market value are equal.

The estimated values of TVA's financial instruments at September 30 are as follows:

	2000		1999	
	Carrying amount	Fair amount	Carrying amount	Fair amount
	(in millions)			
Cash and cash equivalents	$ 361	$ 361	$ 160	$ 160
Investment funds	840	840	731	731
Loans and other long-term receivables	176	176	153	153
Short-term debt	1,274	1,274	982	982
Long-term debt, including current maturities	24,711	23,840	25,394	24,598
Other financing obligations	300	300	—	—

7. BENEFIT PLANS

Pension plan

TVA has a defined benefit plan for most annual employees that provides two benefit structures: the Original Benefit Structure and the Cash Balance Benefit Structure. The plan is controlled and administered by a legal entity separate from TVA, the TVA Retirement System (TVARS), which is governed by its own independent board of directors. The plan assets are primarily stocks and bonds. TVA contributes to the plan such amounts as are agreed upon between the TVA and the TVARS boards of directors, which in no event is less than the amount necessary on an actuarial basis to provide assets sufficient to meet obligations for benefits. No TVA contribution is legally required when the plan's assets are sufficient to meet its accrued liabilities, as determined by an independent outside actuary. This situation has existed for several years.

The pension benefit for a member participating in the Original Benefit Structure is based on the member's years of creditable service, average base pay for the highest three consecutive years and the pension factor for the member's age and years of service, less a Social Security offset.

The pension benefit for a member participating in the Cash Balance Benefit Structure is based on credits accumulated in the member's account and member's age. A member's account receives credits each pay period equal to 6.0 percent of his or her straight-time earnings. The account also increases at an interest rate equal to the change in the Consumer Price Index (CPI) plus 3.0 percent, which amounted to 5.8 percent in 1998. During 1999 plan amendments were effected such that the interest rate may not be less than 6.0 percent nor more than 10.0 percent. The actual changes in the CPI for 2000 and 1999 were 2.0 percent and 1.6 percent, respectively, resulting in the minimum of 6.0 percent for each year.

TVARS also maintains a defined contribution plan, a 401(k) plan, to which TVA makes matching contributions of 25 cents on the dollar (up to 1.5 percent of pay) for members participating in the Original Benefit Structure and of 75 cents on the dollar (up to 4.5 percent of pay) for members participating in the Cash Balance Benefit Structure.

During 1999 TVA changed its accounting policy for the method of determining the market-related value of pension assets, resulting in a one-time gain of approximately $217 million. This gain is presented on the Statement of Income under the caption "Cumulative effect of change in accounting principle."

The discount rate used to determine the actuarial present value of the projected benefit obligation was 8.0 percent in 2000, 7.5 percent in 1999 and 7.0 percent in 1998. The assumed annual rates of increase in future compensation levels for 2000, 1999 and 1998 ranged from 3.3 to 8.3 percent. The expected long-term rate of return on plan assets was 10.0 percent for 2000 and 1999 and 11.0 percent for 1998.

During 2000, plan amendments were effected such that certain pension benefits were enhanced, resulting in approximately $250 million in additional pension plan benefit obligations.

Other postretirement benefits

TVA sponsors an unfunded postretirement plan that provides for nonvested contributions toward the cost of certain retirees' medical coverage. This plan formerly covered all retirees participating in the TVA medical plan, and TVA's contributions were a flat dollar amount based upon the participants' age and years of service and certain payments toward the plan costs. This plan now operates on a much more limited basis, only for certain retirees and surviving dependents who do not qualify for TVARS benefits.

During 2000 these postretirement benefits were enhanced to help covered retirees offset the cost of medical coverage, resulting in approximately $16 million in additional postretirement benefit obligations.

The annual assumed cost trend for covered benefits is 9.0 percent in 2000, decreasing by one-half percent per year to a level of 5.0 percent in 2008 and thereafter. For 1999 and 1998, annual trend rates of 9.5 percent and 10.0 percent, respectively, were assumed. The effect of the change in assumptions of the cost basis was not significant. Increasing/(reducing) the assumed health-care cost trend rates by 1 percent would increase/(reduce) the accumulated postretirement benefit obligation (APBO) as of September 30, 2000, by $9 million/($8 million) and the aggregated service and interest cost components of net periodic postretirement benefit cost for 2000 by $2 million/($1 million).

The weighted average discount rate used in determining the APBO was 8.0 percent for 2000, 7.5 percent for 1999 and 7.0 percent for 1998. Any net unrecognized gain or loss resulting from experience different from that assumed or from changes in assumptions, and which is in excess of 10 percent of the APBO, is amortized over the average remaining service period of active plan participants.

Other postemployment benefits

Other postemployment benefits include workers' compensation provided to former or inactive employees, their beneficiaries and covered dependents for the period after employment but before retirement. Adoption of SFAS No. 112, *Employers Accounting for Postemployment Benefits*, in 1995 changed TVA's method of accounting practice from recognizing costs as benefits are paid to accruing the expected costs of providing these benefits. In connection with the adoption of SFAS No. 112 and related approval by its Board of Directors, TVA recorded the transition obligation as a regulatory asset. The regulatory asset is being amortized over approximately 15 years, whereby the annual expense will approximate the expense that would have been recorded on an as-paid basis. In 2000 TVA accelerated amortization of the regulatory asset approximately $80 million in accordance with its accounting policy as previously described *(see note 1 — Accelerated amortization)*.

The components of pension expense and other postretirement benefits expense for the years ended September 30 were:

	Pension Benefits		Other Postretirement Benefits	
	2000	1999	2000	1999
	(in millions)			
Change in benefit obligation				
Benefit obligation at beginning of year	$ 5,031	$ 5,645	$ 151	$ 206
Service cost	76	94	5	5
Interest cost	367	374	11	14
Plan participants' contributions	32	34	—	—
Amendments, including other events	250	—	16	(48)
Actuarial (gain)/loss	20	(853)	(33)	(3)
Net transfers to variable fund/401(k) plan	(23)	(1)	—	—
Expenses paid	(3)	(3)	—	—
Benefits paid	(289)	(259)	(17)	(23)
Benefit obligation at end of year	$ 5,461	$ 5,031	$ 133	$ 151
Change in plan assets				
Fair value of plan assets at beginning of year	$ 6,842	$ 5,968	$ —	$ —
Adjustment to reconcile to system asset value	(13)	5	—	—
Actual return on plan assets	764	1,098	—	—
Plan participants' contributions	32	34	—	—
Net transfers to variable fund/401(k) plan	(23)	(1)	—	—
Employer contributions	3	—	17	23
Expenses paid	(4)	(3)	—	—
Benefits paid	(289)	(259)	(17)	(23)
Fair value of plan assets at end of year	$ 7,312	$ 6,842	$ —	$ —
Funded status	$ 1,851	$ 1,811	$(133)	$(151)
Unrecognized net actuarial (gain)/loss	(1,649)	(1,540)	(32)	1
Unrecognized prior service cost	492	266	(48)	(70)
Prepaid (accrued) benefit cost	$ 694	$ 537	$(213)	$(220)

	Pension Benefits			Other Postretirement Benefits		
	2000	1999	1998	2000	1999	1998
	(in millions)					
Components of net periodic benefit cost						
Service cost	$ 76	$ 94	$ 67	$ 5	$ 5	$ 8
Interest cost	367	374	328	11	14	26
Expected return on plan assets	(602)	(591)	(479)	n/a	n/a	n/a
Amortization of prior service cost	24	24	—	(6)	(2)	—
Amortization of transition obligation	—	—	—	—	—	—
Recognized net actuarial loss	(19)	—	—	—	—	—
Net periodic benefit cost	(154)	(99)	(84)	10	17	34
Other events	—	(217)	111	—	—	(121)
Total benefits cost/(income)	$(154)	$(316)	$ 27	$ 10	$ 17	$ (87)

8. MAJOR CUSTOMERS

Five municipal customers purchase power from TVA under long-term contracts, which require 10 years' notice to terminate.

These customers account for an aggregate of total power sales as follows: 27 percent for 2000 and 1999 and 29 percent for 1998.

9. COMMITMENTS AND CONTINGENCIES

Commitments

Leases

Certain property, plant and equipment are leased under agreements with terms ranging from one to 30 years. Most of the agreements include purchase options or renewal options that cover substantially all the economic lives of the properties. Obligations under capital lease agreements in effect at September 30, 2000, total $36 million annually through 2005, and an aggregate of $193 million thereafter, for a total commitment of $373 million. Of this amount, $192 million is interest.

Construction Commitments

TVA has entered into approximately $600 million in long-term commitments consisting of the purchase of generating assets of approximately $450 million and major maintenance expenditures of $150 million. Terms of the contracts extend into 2003.

Fuel Purchase Commitments

TVA has entered into approximately $4 billion in long-term commitments ranging in terms of up to six years for the purchase of coal, and approximately $1 billion in long-term commitments ranging in terms of up to ten years for the purchase and fabrication of uranium.

Purchased Power

TVA has entered into an agreement for the purchase of power from a 440 megawatt, lignite-fired electrical generating plant. The agreement calls for TVA to purchase the plant's output for a 30-year period beginning on the date of first generation expected in 2001. Pricing of the contract includes fixed and variable components with minimum estimated power purchases approximating $4 billion over the life of the contract.

Contingencies

Nuclear Insurance

The Price-Anderson Act sets forth an indemnification and limitation of liability plan for the U.S. nuclear industry. All NRC licensees, including TVA, maintain nuclear liability insurance in the amount of $200 million for each plant with an operating license. The second level of financial protection required is the industry's retrospective assessment plan, using deferred premium charges. The maximum amount of the deferred premium for each nuclear incident is approximately $88 million per reactor, but not more than $10 million per reactor may be charged in any one year for each incident. TVA could be required to pay a maximum of $528 million per nuclear incident on the basis of its six licensed units, but it would have to pay no more than $60 million per incident in any one year.

In accordance with NRC regulations, TVA carries property and decontamination insurance of $1.06 billion at each licensed nuclear plant for the cost of stabilizing or shutting down a reactor after an accident. Some of this insurance may require the payment of retrospective premiums of up to a maximum of approximately $16 million.

Clean Air Legislation

Title IV of the Clean Air Act Amendments (CAAA) of 1990 requires coal-fired generation units to reduce their sulfur dioxide (SO_2) and nitrogen oxide (NO_x) emissions in two phases in order to control acid rain. The Phase I compliance period commenced on January 1, 1995, for SO_2 and January 1, 1996, for NO_x, while the Phase II compliance period commenced on January 1, 2000. Based on the level of emissions, 26 of TVA's 59 operating coal-fired units are classified as Phase I units, with the remaining units being Phase II units. Compliance with these requirements has resulted in substantial expenditures for the reduction of emissions at TVA's coal-fired generating plants.

TVA's strategy for complying with the 1990 CAAA includes the use of scrubbers at two fossil units and the use of lower-sulfur coal at other fossil units to reduce SO_2 emissions. TVA has completed all planned scrubbers and is on schedule to complete the changeover to lower-sulfer coal.

NO_x reductions were required for 58 of TVA's 59 coal-fired units. The only TVA unit for which NO_x reductions are not required under the 1990 CAAA is the Atmospheric Fluidized Bed Unit 10 at TVA's Shawnee Fossil Plant. The NO_x reductions for the other 58 units were achieved through the installation of low-nitrogen-oxide burners (LNBs) and/or overfire air at 40 units and boiler optimization on the remaining 18 TVA units. In 1996 TVA selected an early election option for four of these 58 units, allowing the four units at John Sevier Fossil Plant to be limited to Phase I NO_x levels through 2007. In 2008 these four units will have to meet lower Phase 2 NO_x levels. For the remaining 54 units, TVA has elected to average NO_x emissions to meet a 54 unit NO_x averaging plan. This averaging plan option lets TVA optimize the cost of NO_x reductions while being in full compliance with the 1990 CAAA Title IV NO_x requirements. In addition to TVA's Title IV projects during 2000, TVA also completed installation of the first selective catalytic reduction system (SCR) on the TVA power system. SCRs are state-of-the-art NO_x emission-control technology. Seventeen other SCRs are planned to be installed on 24 more TVA units. This follows up on a commitment TVA made to further reduce NO_x emissions on its system. Installation of these SCRs will also comply with the Environmental Protection Agency's (EPA) recent section 110 State Implementation Plan NO_x Reduction rule.

Expenditures related to the Clean Air projects during 2000 and 1999 were approximately $125 million and $77 million, respectively. The cost of the SCR strategy is estimated to be between $800 million and $900 million. The total cost of compliance cannot reasonably be determined at this time because of the uncertainties surrounding emerging EPA regulations, resultant compliance strategies, potential for development of new emission control technologies, court litigation and future amendments to the Clean Air Act, but the total cost could exceed $2.5 billion.

EPA is investigating whether coal-fired utilities in the eastern U.S., including TVA, may have modified their coal-fired boilers without complying with new source review requirements. The outcome of this investigation is ongoing and uncertain. TVA contends EPA's investigation is based on a new interpretation of an old rule and that TVA has routinely maintained its power plants to ensure efficient, reliable power generation while complying with all requirements. However, EPA has issued TVA an administrative order directing TVA to put new source controls on 14 of its units and to evaluate whether more controls should be installed on other units. TVA has challenged the validity of this order and the Eleventh Circuit Court of Appeals has stayed the order pending its review. It is not possible to predict with certainty what impact implementation of EPA's order would have on TVA if TVA's challenge is unsuccessful. If EPA substantially prevails, TVA could be required to incur capital costs in excess of $3 billion (net present value) by 2010 to 2015. Any additional controls that TVA could be required to install on units as a result of this matter would, however, also be sufficient to comply with reduction requirements that are anticipated under other air quality programs discussed above. Thus, because of the other environmental program requirements, TVA would, in any event, likely have to incur a substantial portion of the costs that might result from the EPA enforcement action, albeit the schedule for the installation of the controls could be substantially accelerated by the EPA enforcement action. TVA fully supports the need to further reduce emissions from coal-fired plants and seeks a resolution that will not put TVA customers and the region at a disadvantage.

Hazardous substances

The release and cleanup of hazardous substances are regulated under the Comprehensive Environmental Response, Compensation, and Liability Act (CERCLA). In a manner similar to many other industries and power systems, TVA has generated or used hazardous substances over the years. TVA has been identified as a potentially responsible party with respect to four off-site disposal areas. TVA's liability at these sites has not yet been determined. In addition, TVA is currently investigating one other TVA-owned site under a state statute similar to CERCLA. TVA may have cleanup responsibilities at this site by virtue of its control of the property. TVA's potential liabilities for its share of cleanup costs at all of these sites are uncertain but are not expected to have a significant impact on TVA's financial position or results of operations.

Pending litigation

EPA has issued TVA an administrative order directing TVA to put new source controls on 14 of its units and to evaluate whether more controls should be installed on other units. TVA has challenged the validity of this order. It is not possible to predict with certainty what impact implementation of EPA's order would have on TVA if TVA's challenge is unsuccessful. If EPA substantially prevails, TVA could be required to incur capital costs in excess of $3 billion (net present value) by 2010 to 2015 in order to implement EPA's order.

TVA is a party to various civil lawsuits and claims that have arisen in the ordinary course of its business. Although the outcome of these other lawsuits and claims cannot be predicted with any certainty, it is the opinion of TVA counsel that the ultimate outcome should not have a material adverse effect on TVA's financial position or results of operations.

Decommissioning costs

Provision for decommissioning costs of nuclear generating units is based on the estimated cost to dismantle and decontaminate the facilities to meet NRC criteria for license termination. The Financial Accounting Standards Board (FASB) has reached several tentative conclusions with respect to its project regarding the accounting for closure and removal of long-lived assets, including the decommissioning of nuclear generating units. Effective for 1998 TVA changed its method of accounting for decommissioning costs and related liabilities in order to comply with certain of the FASB's tentative conclusions, as well as certain rate-setting actions. The FASB issued an exposure draft in the first quarter of 2000; however, it is uncertain when a final statement will be issued and what impact it may ultimately have on TVA's financial position or results of operations.

TVA recognizes as incurred all obligations related to closure and removal of its nuclear units. The liability for closure is measured as the present value of the estimated cash flows required to satisfy the related obligation and discounted at a determined risk-free rate of interest. The charge to recognize any additional obligation is effected by adjusting the corresponding regulatory asset. Earnings from decommissioning fund investments, amortization expense of the decommissioning regulatory asset and interest expense on the decommissioning liability are deferred in accordance with SFAS No. 71, *Accounting for the Effects of Certain Types of Regulation.* In 2000 TVA performed engineering studies in accordance with NRC revised guidelines. The studies resulted in a $209 million decrease in TVA's required decommissioning obligation, which was recorded along with a corresponding reduction in the regulatory asset. At September 30, 2000, the present value of the estimated future decommissioning cost of $742 million is included in other liabilities; the unamortized regulatory asset of $144 million is included in deferred charges. The decommissioning cost estimates from the 2000 study are based on prompt dismantlement and removal of the plant from service. The actual decommissioning costs may vary from the estimates because of changes in the assumed dates of decommissioning, changes in regulatory requirements, changes in technology and changes in the cost of labor, materials and equipment.

TVA maintains an investment trust fund to provide funding for the decommissioning of nuclear power plants. As of September 30, 2000, the decommissioning trust fund investments totaled $833 million and were invested in securities designed to achieve a return in line with overall equity market performance.

Effective November 23, 1998, the NRC amended its regulations regarding decommissioning funding. These regulations require TVA to provide financial assurance for decommissioning funding through the use of certain prescribed mechanisms such as the trust agreements with independent money managers entered into by TVA in May 1997. These new regulations did not have a material impact on TVA's financial position or results of operations.

Cost-Based Regulation

As a regulated entity, TVA is subject to the provisions of SFAS No. 71, *Accounting for the*

Effects of Certain Types of Regulation. Accordingly, TVA records certain assets and liabilities that result from the effects of the ratemaking process that would not be recorded under generally accepted accounting principles for nonregulated entities. Currently, the electric utility industry is predominantly regulated on a basis designed to recover the cost of providing electric power to its customers. If cost-based regulation were to be discontinued in the industry for any reason, profits could be reduced and utilities might be required to reduce their asset balances to reflect a market basis less than cost. Discontinuance of cost-based regulation would also require affected utilities to write-off their associated regulatory assets. Such regulatory assets for TVA total approximately $979 million at September 30, 2000, along with approximately $6.3 billion of deferred nuclear plants. Management cannot predict the potential impact, if any, of the change in the regulatory environment on TVA's future financial position and results of operations.

10. NONPOWER PROGRAMS

Certain TVA activities formerly referred to as "nonpower" programs provide various public services, including managing navigable river channels, providing flood control and overseeing recreation facilities. TVA's responsibilities include general stewardship of land, water and wildlife resources.

Funding for the nonpower programs had historically been primarily provided through Federal appropriations. Certain non-power program activities have also been funded by user fees and outside services revenues. In 1999 TVA received total Federal appropriations of approximately $50 million, of which $43 million was for stewardship activities and $7 million was for TVA's Land Between the Lakes National Recreation Area (LBL). During 1998 TVA received total Federal appropriations of approximately $70 million, of which $63 million was for stewardship activities, including $3 million for the environmental clean-up work at the Muscle Shoals, Ala., reservation, and $7 million was for LBL. As discussed below, TVA received no Federal appropriations in 2000.

In October 1997, Congress passed legislation that directed TVA to fund essential stewardship activities related to its management of the Tennessee River system and TVA properties with power funds in the event that there were insufficient appropriations or other available funds to pay for such activities in any year. Congress did not provide any appropriations to TVA to fund such activities in 2000. Consequently, during 2000, TVA paid $72 million for essential stewardship activities primarily with power revenues, with the remainder funded with user fees, other forms of nonpower revenues and nonpower fund balances unused in prior years. In addition, administrative jurisdiction over LBL was transferred to the Secretary of Agriculture effective October 1, 1999. TVA is responsible for certain transition costs associated with the transfer of LBL, estimated to be approximately $7 million at September 30, 2000. TVA retains responsibility for management of the remaining nonpower assets and settlement of nonpower obligations.

At September 30, 2000, TVA had transferred $56 million of property and equipment to the U.S. Forest Service. After this transfer the completed plant of the nonpower programs consists of multipurpose dams and other plant. At September 30, 2000, the net completed plant balances for multipurpose dams and other plant were $683 million and $57 million, respectively. At September 30, 1999, the net completed plant balances for multipurpose dams and other plant were $692 million and $112 million, respectively.

REPORT OF INDEPENDENT ACCOUNTANTS

To the Board of Directors of the Tennessee Valley Authority

In our opinion, the accompanying balance sheets (power program and all programs) and the related statements of income (power program), changes in proprietary capital (power program and nonpower programs), net expense (nonpower programs) and of cash flows (power program and all programs) present fairly, in all material respects, the financial position of the power program and all programs of the Tennessee Valley Authority as of September 30, 2000 and 1999, the results of operations of the power program and nonpower programs and cash flows of the power program and all programs for each of the three years in the period ended September 30, 2000, in conformity with accounting principles generally accepted in the United States. These financial statements are the responsibility of the Tennessee Valley Authority's management; our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements in accordance with auditing standards generally accepted in the United States and *Government Auditing Standards* issued by the Comptroller General of the United States, which require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for the opinion expressed above. We have also issued our report dated October 24, 2000, on TVA's compliance with laws and regulations and internal control over financial reporting. That report is an integral part of our audit conducted under *Government Auditing Standards* that should be read along with this report on the financial statements.

As discussed in note 7 to the financial statements, TVA changed its method for determining the market-related value of pension assets in 1999.

PricewaterhouseCoopers LLP

PricewaterhouseCoopers LLP
Knoxville, Tennessee
October 24, 2000

REPORT OF MANAGEMENT

Management is responsible for the preparation, integrity and objectivity of the financial statements of the Tennessee Valley Authority as well as all other information contained in the annual report. The financial statements have been prepared in conformity with generally accepted accounting principles applied on a consistent basis and, in some cases, reflect amounts based on the best estimates and judgments of management, giving due consideration to materiality. Financial information contained in the annual report is consistent with that in the financial statements.

The Tennessee Valley Authority maintains an adequate system of internal controls to provide reasonable assurance that transactions are executed in accordance with management's authorization, that financial statements are prepared in accordance with generally accepted accounting principles, and that the assets of the corporation are properly safeguarded. The system of internal controls is documented, evaluated and tested on a continuing basis. No internal control system can provide absolute assurance that errors and irregularities will not occur due to the inherent limitations of the effectiveness of internal controls; however, management strives to maintain a balance, recognizing that the cost of such a system should not exceed the benefits derived. No material internal control weaknesses have been reported to management.

PricewaterhouseCoopers LLP was engaged to audit the financial statements of the Tennessee Valley Authority and issue reports thereon. Its audits were conducted in accordance with generally accepted auditing standards. Such standards require a review of internal controls and an examination of selected transactions and other procedures sufficient to provide reasonable assurance that the financial statements neither are misleading nor contain material errors. The Report of Independent Accountants does not limit the responsibility of management for information contained in the financial statements and elsewhere in the annual report.

David N. Smith
Chief Financial Officer
and Executive Vice President of Financial Services